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TECHNIQUES OF INVESTIGATION FOR ASSESSMENT

Vol 1

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Techniques of Investigation for Assessment

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Foreword

As the financial ecosystem is evolving and changing rapidly, the tax authorities are required to keep themselves abreast with the latest developments in the field of tax investigations. There has been a seminal change in the way in which financial transactions are carried out. Owing to that, the methodology to track and analyse such transactions from the perspective of a tax investigator has also undergone a drastic change. In this backdrop, a need was felt to revise the existing *'Manual on Techniques of Investigation'*, which was last released in the year 2002.

The scope of the updated and revised Manual is to give the officers of the Income-tax Department an overview of the modern techniques of investigations. Two volumes of the revised Manual have been finalized. The chapters highlight the issues, legal position and techniques which the departmental officers can use to investigate the case and to tackle the tax evasion.

Volume – I deals with the topics discussed in the earlier edition and has been comprehensively revised and rewritten bearing in mind the latest developments. Specifically, the topic "Examination of book of accounts", has been redrafted keeping in view that the earlier system of manual book-keeping has been now replaced with maintenance of books of account over digital medium.

Volume – II of the Manual contains all new chapters and focuses on the contemporary aspects of tax investigations and deals with the issue involved in investigation of undisclosed foreign assets, transactions in commodity markets, money and currency markets, derivatives etc. It also deals with the latest technology for handling digital evidences, conducting forensic examination, the essential aspects of cryptocurrencies etc.

I would like to place on record my special appreciation for the efforts of all the members of the Committee and other officers associated with the mammoth task of rewriting this Manual. I hope, this Manual will act as a useful reference point for the officers of the department, while conducting inquiries and investigations.

(P.C. Mody)
Chairman and Member (Investigation)[i/c]
Central Board of Direct Taxes

New Delhi
Dated: 19/07/2019

Preface

The Board had constituted a Committee on 27.11.2017 for review and update the departmental publication of "Techniques of Investigation Manual" (Vol. I to V) 2002. The need for the same had arisen from the fact that the earlier publication was more than 16 years old. The new series of 'Techniques of Investigation' is an effort to sensitize and educate the officers to effectively equip them with the requisite skill set. The Committee decided to bring the manual in seven volumes. The Committee has great pleasure in bringing out the present Volume 1 of the Manual which contains introductory and general chapters. The work involved re-writing the existing chapters incorporating the refinements undergone in old methods of tax evasion and incorporating the changes in the statute and the procedures.

The basic principles of taxation are as old as organised human society. Several ancient civilisations, including the Greeks and Romans, levied taxes on their citizens to pay for military expenses and other public services. Taxation in India is rooted from quiet early period. The celebrated poet Kalidas in his epic poem Raghuvansa has said:

> *"It was only for the good of his subjects that he collected taxes from them, just as the sun draws moisture from the Earth to give it back a thousand fold."*

However, the human tendency to avoid paying taxes was also known to exist from earlier times. People had started using certain avenues to avoid payment of taxes. Thus the role of the tax administrators became crucial in ensuring that every eligible person must pay tax correctly. So the provision of investigation in the existing income-tax law is an important aspect. These investigative powers coupled with information gathering tools form the backbone of any judicious assessment order.

Nowadays businesses have witnessed significant technological advancements. They have adopted technology, resulting in change in the methods and manner of doing business. As a result, the scope and meaning of investigation has also changed. The internet, perhaps the most important achievement of mankind, has made practically all information available with us in no time. Investigation today has to match with the fast pace of technological developments and the technological infrastructure of the income-tax department is playing a significant role. The Tax Authorities have to scale themselves up to meet the newer challenges posed to them in the form of digital transactions of business affairs.

The Government has recently taken various initiatives to unearth the black money *viz* Demonetization, Revamping the Benami Transactions Act, bringing in various amendments in respect of reporting cash transaction and transactions over a particular threshold, mandatory quoting of PAN, etc. It is now the responsibility of the Tax Officers to use the information and authority under the law to enforce payment of correct taxes else the key steps undertaken by the Government to enhance the tax compliance would be rendered futile.

As the basic concepts of investigation has not changed, the bulk of the material for most of the general chapters has also remained unchanged. At the same time there in value addition to them taking into account the new modes of avoiding or evading the taxes. The chapter of "Examination book of accounts" which was with relevance to manual book of account has been rewritten and replaced with new topic of "Investigation of Computerized book of accounts". This comprehensive write-up includes Investigation of accounts in Tally ERP, Investigation of accounts in SAP ERP, techniques of investigation of computerized accounts and application of forensic accounting for investigation. It has laid out the broader contours of the investigative techniques especially in the wake of digital accounting. The chapter on 'Benami Transactions' has been supplemented with the provisions of PBPT Act and the provisions of GAAR has been included in on the topic of tax avoidance. The recent judicial pronouncements on the relevant topics have also been incorporated.

The chapters are not an exhaustive list of techniques of investigation as the tax avoidance and evasion practices are quite diverse and dynamic in nature. However, it intends to highlight and guide the officers and make them aware about the existing provisions of law and techniques that they can apply independently to tackle the tax evasion issue in the facts and circumstances of the particular case. We attempted to utilize the earlier and newer investigation techniques to address the issue of tax avoidance and evasion in the complex digital business space. It is hoped that officers in the field find this book useful and make best use of the intended knowledge sharing while solving cases of tax evasion effectively.

The Committee acknowledges the effort of all the officers who have contributed material and made value addition for compilation of this Volume. We are also grateful to the Editorial Board for going painstakingly through the write-ups and for their valuable inputs.

N.P. Sinha
Chairman of the Committee

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CHAPTER

1

Investigation Cases: General Discussion

1. Taxes are the major sources of revenue of Indian government. Tax evasion causes economic inequality. Many reform measures and initiatives of government have to be set aside and welfare activities are getting affected. Black money causes inflation and value erosion. Tax evaders have been developing increasingly sophisticated methods of concealing income. The books of accounts produced before the Department is so "prepared" that it is becoming increasingly difficult to detect concealments from these. Evasion of tax is more prevalent amongst persons having income from business and profession. Essentially, tax is evaded either by understating receipts or by inflating expenditure. In a case where accounts are correct in respect of both income and expenditure, evasion is resorted to, by making false claims of depreciation, deductions or other benefits available under the Act. Another common device is of inflating exempt incomes e.g. agricultural income, or diverting expenditure pertaining to exempt incomes to taxable incomes, e.g. income from export business and domestic business. Few other examples are charging personal expenses to revenue, submission of false certificates to claim exemption. With advent of technology, the core tax planning has shifted from evasion (being a raw method) to avoidance of tax (being a sophisticated method). Detection of tax evasion is easier than detection of tax avoidance since the tax avoidance is planned having regard to the loopholes within the legal framework, whereas evasion can be easily detected with the help of digital recording of the transactions.

2. Where the evasion is large and continues over a certain period, the tax payer accumulates black money, which manifests itself in various forms like investment in properties (real estate, gold, ornaments, etc) lavish life style, unaccounted stocks, unsecured loans in the form of cash credits and unreported bank accounts, etc. The real estate or other investments can be in India or outside India.

3. Investigation in a case of suspected tax evasion can be made either directly or indirectly. Investigation is direct when the AO collects incriminating evidence against the assessee and establishes that the receipts are understated or the expenditure is overstated. Where certain receipts have been suppressed he would have

to collect evidence from third parties who have shown payments to the assessee which are not recorded in his books of accounts. Similarly, where abnormal/ false expenses have been recorded in the books of accounts, the AO will have to prove that these are not genuine or that the payees have not rendered any services/ supplied any products/ fixed assets for which payments have been shown. For this books of original entry will have to be examined, and records of production, sale, stocks, wages, stores, fixed assets, etc. subjected to an intelligent scrutiny. The records of major payees or payers will have to be verified. Information will have to be independently gathered to verify the assessee's version. All these information will have to be linked to arrive that a particular transaction in genuine or not. While it seems to be a herculean task with limited availability of evasion related information, certain standard checks and benchmarking of income/ expenditure with industry standards would throw up preliminary area of investigation. Use of digital means and the information available with the other Revenue Departments' and Ministry of Corporate Affairs will help. Goods and Service Tax ('GST') portal can also provide for substantial information which should be used while detecting any discrepancies in the turnover, expenses, etc.

4. The lines of investigation will vary according to the sources of income and information available with the Tax Department before initiating any action. The Government has tightened the reporting process and various agencies (like Banks, Mutual Fund Agencies, Property Registrar, etc) are providing information exceeding particular threshold to the Tax Department under Rule 114E of the Act–basis which AIR information for a particular taxpayer can be generated through system. Such information is a ready source of understanding the economic activity of a particular taxpayer and the deviation of such activity from books of accounts/ return of income can be investigated further. The taxpayers tend to create labrynthine structures to avoid detection, so it's important to trace the maze of Companies involved in the process. This would require identification of common linkages within the Companies (like Directors, Address, etc). Such process can be completed with the help of seeking relevant information from Ministry of Corporate Affairs. Also, every taxpayer is publicizing its business on internet (supported by call centres) and has his own profile (may be Linkedin, etc). Surfing the internet and making few calls asking relevant questions would also provide certain clues which can be investigated further. The sharing of information within the Department is also necessary on a real time basis–so any adverse material found with the third party by another Assessing Officer should be immediately notified to the jurisdictional Assessing Officer to initiate appropriate and timely action. On the basis of the information received, the Tax Authority should determine the action to be undertaken–Summons (u/s 131), Search (*u/s* 132), Survey (*u/s* 133A), Scrutiny proceedings (*u/s* 143), etc. For example, the assessee engaged in a business activity has claimed certain expenditure. The Department received information from sales tax wing regarding a person providing accommodation entries (providing bills without supplying/ rendering goods or services on a commission basis). When the list of creditors of the assessee was examined, the name of such person was also appearing in such list. When further investigated about the nature of services rendered/ goods procured by/ from such person to the assessee, it was revealed and admitted by the assessee that the claim of the expenditure was bogus and the transaction was entered for suppression of true income. Another example could be of a case in which the assessee was receiving rent by letting out a very large building to various tenants, and was showing rental income under the head 'business' after claiming depreciation. A survey *u/s* 133A was conducted in which statements of the tenants were recorded. They accepted that the payments allegedly made

by them as "brokerage" and "commission" were actually rent, and that the assessee had rendered no services. The assessee then admitted that the income was actually from house property. As a result, the claim of depreciation running into crores was held to be inadmissible. This method of investigation may also be called the "source method". What is required is to first ascertain the sources of income of the assessee and then visualise the possible methods of evasion that can be resorted to for suppressing income from these sources. The line of investigation should be developed for each source. In other words, the AO should try to get into the shoes of assessee and figure out how income from a particular source can be suppressed and then devise the line of investigation. For example, in the case of a professional there is little scope of reducing income by inflating expenses. In all probability a professional would try to evade taxes by understating his receipts. Here it would be worthwhile to investigate his receipts, life style and investments etc.

5. The indirect method, on the other hand, involves a reverse process whereby concealed or unrecorded incomes, expenses or assets are traced out by a close scrutiny of the account books, bank pass-books etc., in the light of information collected from diverse sources. This method is based on the net increase in wealth after suitable adjustments for outgoings and may also be called "Investment method". This has been discussed in Chapter III.

6. Once a decision for detailed investigation has been taken, the AO can start preliminary enquiries on the following lines:

i. Ascertaining the names of members of the family, etc.-In the case of an Individual, the names of the assessee's wife, major or minor sons, married or unmarried daughters should be ascertained. In the case of the H.U.F., a genealogical tree showing the names and ages of male members should be drawn up and their relationship with each other clearly brought out by starting from the common ancestor. The trade names of various businesses should be linked up with these names and what business each member actually conducts should be noted. In the case of Firms and Associations of Persons, similar details should be gathered.

ii. **Ascertaining the Companies Belonging to the Same Group:** Similar goes with the corporate entities, i.e., finding the details of all group companies. These details should be readily available on the Registrar of Companies website. The details of transactions between these entities should be analysed.

iii. **Names of Business Units:** Important cases of tax evasion usually come to light when the assessees have expanded their businesses. Such expansion may be through one or different business units. Names of such units should be ascertained. The following sources may be tapped:

Where all the business units belonging to the same group are situated in the same premises, names of all such units can be gathered by personal inspection.

The names of business units of a group are usually given at the same place in the Telephone directory.

- Sometimes, advertisements in the press or elsewhere display the names of various business units belonging to a particular group.
- Balance Sheets and accounts of the known business units should be examined and concerns with whom there are large transactions for a number of years may be checked.

iv. **Assessment Records:** The AO should study assessment records of these concerns from the beginning and note

down important points. This may disclose contradictions in the stands taken by the assessees at different stages. If required, the AO should go to the places where these units are being assessed and study their conduct during the assessment proceedings. Unified scrutiny of all the assessment records is essential as only then relevant clues from various files can be noted.

v. **Scrutiny of Financial Statements:** The financial statements of the taxpayer should be closely scrutinized to ascertain the areas which requires further investigation (like heavy capitalization, increase in level of expenditure as compared to the earlier years, reduction/ increase in turnover or profitability, etc). The Department in parallel also collates information electronically through various sources and the same should also be matched with the financial statements.

vi. **List of Immovable Properties:** A list of immovable properties with detailed particulars should be prepared from the assessment records of the persons belonging to the group. Again help of information available with the department by way of AIR can be scrutinized to check these details.

vii. **List of Main Employees:** A list of employees with salary above a certain limit, depending upon the nature of the case, should be obtained.

viii. **List of Major Shareholders:** In case of companies, list of major shareholders along with their addresses and their shareholdings should be drawn up. As mentioned above, these details can easily be obtained from the website of Registrar of Companies.

ix. **List of Banks:** With which the assessees have accounts and the list of persons in whose names large transactions have been shown should be prepared. Additionally, large cash deposits & withdrawals should be scrutized.

x. List of major debtors and creditors, say over Rs. 100000/- along with complete addresses should be drawn.

xi. Comparative Charts of the expenditure incurred, say for last three years–trace abnormal behaviour in the expenditure details (key accounts to be looked at are Commission, Professional Services, etc).

xii. Investments made in various sources, along with proof and back-ups for cross verification.

xiii. Borrowings availed, along with identification of parties and basic details in terms of PAN, Address, etc.

xiv. Stock register, any spike or significant reduction in activity should be traced–the same can be tallied also during the course of survey.

xv. Details available internally/ externally–collate all the details available within the Department (Project Insight, AIR, etc) and with other Government Agencies. Also, collate the information available in public sources through internet. Such information should be cross checked with the books of accounts of the taxpayer.

While asking for the information from the taxpayer, a tendency it is seen that citing voluminous details, the taxpayer offers submitting information on a sample basis. Such samples should be selected by the Assessing Officer after assessing the ledger accounts and not by the taxpayer himself to suit his own needs.

In digital world, there is no dearth of information available–it is important that the inquiry or investigation should be focused. The Assessing Officer should use his/ her acumen to track all sources of information, connect the dots and pen down the pain areas of the Taxpayer. Such information should not at any stage of

preliminary inquiry be revealed to the assessee. At times, asking for certain irrelevant information along with necessary ones will help creating confusion in the mind of the assessee and his consultants. Show Cause Notice should be given only at the stage when adequate information is available to fix the onus on the assessee. Some of the information can be left out from Show Cause to be used at subsequent stage or while framing counters to the assessee's objection while drafting the assessment order. The order should clearly bring out all the information collate and if necessary, the Assessing Officer should copy paste the extracts of details relied upon or make the same as a part of Annexure to the Assessment Order.

7. Verification of allegations in tax evasion petitions etc.- For a proper utilization of information relating to tax evasion contained in anonymous, pseudonymous and other petitions, following procedure is suggested:

i. The petition should be kept in the custody of the AO.

ii. A summary of all the allegations should be placed in a confidential folder.

iii. The allegations should not be revealed to the assessee in the first instance. This has the disadvantage of letting the assessee know exactly which of his secrets have come to the knowledge of the Department. By keeping the assessee guessing, there is a good chance of getting a complete admission. For instance, in a case where a number of properties were purchased by the assessee in various names, the AO got a surprise when by not revealing to the assessee the details of the information he had, the AO found that a valuable property not in his knowledge had also been purchased as later admitted by the assessee. In another case, by keeping back the knowledge about a bank account of the assessee and by only indicating that he was aware of bank accounts, the AO was able to bring out 10 secret bank accounts till the one he was aware of came out. Therefore, while the assessment should not be completed without giving the assessee a fair opportunity to meet the entire evidence against him, all necessary information about the allegation should as far as possible be gathered first, verified from independent sources before confronting the assessee with the same. Accordingly, the AO should develop great amount of probing skills to bring out the required information from the assessee. Right questions should be posed before the assessee to bring out the answers required by the AO.

iv. If some of the allegations are vague, an effort should be made to contact the informer and to gather specific information. In case this is not possible, much time need not be wasted on such allegations.

v. The assessment records should be studied and specific information, e.g. information relating to Bank accounts, deposits, cash credits, property, shares etc. should be verified from the records. Any discrepancies or items requiring further enquiry, should be noted

vi. Before examining the assessee in regard to such items as are not appearing in the copies or extracts of accounts available in income-tax records, evidence should be collected independently to verify their genuineness.

vii. While collecting independent evidence or obtaining copies of accounts, it is preferable to get them demi-officially through the AOs assessing the parties concerned so as to avoid prior consultation by the parties with the assessee.

viii. After collecting independent evidence on the points in dispute, these should be formally put to the assessee for his explanation. In investigation cases, it is

advisable to first collect materials in the absence of the assessee. The information collected can then be put to the assessee and the parties formally examined and cross-examined. The parties will normally tell the truth when they are approached by the AO as the assessee will have no occasion to tutor them. Later on when they formally appear before the AO in the presence of the assessee, it will be difficult to retract from what they had stated originally. In one case, a jeweller who had made speculation profit of Rs. 1,20,000/-, also showed speculation losses of Rs. 1,50,000/- to goldsmiths who prepared ornaments for him. Most of the goldsmiths lived in the same locality. At first the AO examined all the goldsmiths. All of them stated that they had never entered into speculation and they did not know how speculation was carried on. The information collected was put to the assessee and he was asked to produce the goldsmiths in support of his claim. He produced them. They admitted having received speculation profit but could not explain how speculation was carried on. They could not also reconcile their statements with that given earlier. When asked as to how the profit was utilised, most of them stated that it had been spent on serious illness in the family but could not give the name of the doctor who had treated the patients. The matter was followed up and it was found that the losses were not genuine.

ix. After hearing the assessee, further enquiries which may be found necessary, should be pursued. Thereafter, the assessee may be allowed a final opportunity of rebutting the conclusions tentatively arrived at.

x. The AOs should not make unrealistic or over-pitched assessments. Additions to disclosed income should not be made without:

- Making requisite enquiries;
- Bringing on record sufficient evidence in support of the additions made;
- Confronting the assessee with the material collected by the AO; and
- Affording a reasonable opportunity to the assessee to rebut the said material and explain his case.

8. Duplicate Set of Accounts: Before commencing the scrutiny of books of account, external characteristics of the set of books produced should be observed. When the books are completely re-written, they generally have the appearance of a comparatively new set of accounts provided the examination is taken up not too long after the close of the accounting year. In such cases, the AO should be on his guard if he finds that:

i. **The Books are Spotless:** The books are not likely to be spotless if written regularly from day to day.

ii. **The Entries are Throughout in One Hand:** If the transactions have been written throughout by one hand, it should be seen whether the person concerned was in assessee's employment throughout the year. The names of the persons who have written the account books should be ascertained first and then the assessee should be asked to show that the salaries of those persons have been debited in the books. Sometimes it happens that the person who has written the accounts was not in assessee's employment in the year to which the books relate. It may also be useful to compare handwritings of the entries in the different account books for different parts of the year. The pages of the cash book should be turned over to find out if the correct year has been given throughout. Very often, advance years are given at places. For example, a person

writing the books for 1998 in 1999 may by force of habit mention 1999 instead of 1998 at several places. This will be definitely a suspicious feature and if followed up may lead to the conclusion that the books were written in 1999 and not in 1998 to which they are alleged to relate.

iii. However, these days with increasing use of digital record keeping information is stored, transmitted or processed in digital form. Accordingly, records including books of account are maintained in digital form, most organisations use networks connecting different PCs spread across geographical locations, etc. In such a situation it is important to find a logical error since digital book keeping shall not throw up any manual error in the books of accounts. For investigating data in digital form would require data integrity and authenticity. Some of the grounds on which integrity of seized data can be violated/ altered are as under:

a. When a system, seized on a particular date, is switched on or booted at a later date to view its content, the date and time of opening these files automatically gets modified.

b. If a seized system is not booted on its own and its hard disk is attached to another system, even then operating system has an automatic functionality to write to all attached media.

c. Accessing a system or hard disk in any way without the use of write-protect devices causes change in the hash value or digital fingerprint of the disk. This can render the evidence on such disks inadmissible.

d. Sometimes even valuable data may be lost because of use of unsound methods.

iv. It is important that the Assessing Officer should train himself or take the help of trained professional in understanding how the accounting system/ software of the taxpayer works–the same will help in identification of relevant information within minimal time.

If need be–the Department should seek help of Agencies like National Informatics Centre to find the digital footprint of the details and restore the deleted files.

9. In important cases of suspected tax evasion the account books produced by the assessee should be carefully examined. The scrutiny should not be confined merely to study of the statements furnished by the assessee in support of the return of income. Unless a thorough examination of the account books is carried out, it may not be possible to arrive at the actual profits. A tendency is noticed among some AOs not to look into the account books at all and to confine themselves only to the study of particulars and information furnished by assessee either voluntarily or at the instance of the AO.

10. Scrutiny of Trading Account, Manufacturing Account, P&L Account, and Balance Sheet generally forms the starting point of enquiry. However, in order to locate the chinks in the wall built by the tax evader, systematic and coordinated scrutiny of the various account books, bank pass book and other subsidiary records should be undertaken. Sometimes, it may be necessary to apply all the checks while at times even a single check may suffice.

11. Even in cases of major tax evasion, a large percentage of entries in the books may be genuine. Out of tens of thousands of entries, the key would probably be furnished by only a few. The various ways in which an AO can equip

himself to spot out such suspicious and vital entries include:

i. **Obtaining Information from Outside Sources:** An alert AO should always make intelligent use of information or allegations which come into his possession either digitally or manually.

ii. **Study of Various Techniques of Manipulations:** Various techniques of manipulation adopted by assessees have been discussed in the subsequent chapters. It is necessary that the AO should be intimately acquainted with these. This knowledge coupled with experience enables him to develop the insight to read the accounts as an open book.

iii. **Development of Capacity for Detecting Clues:** Once, for good reasons, it is suspected that a particular entry in the account books is spurious, the AO must follow it up from every angle. If he approaches the problem in a systematic manner, he may not have to waste much time. The art of selecting entries for verification is the most important skill for any investigator. The AO has got to restrict his enquiries to a select few. It is in the selection of these that the skill of an AO lies.

iv. **Tracking of Digital Footprint of the Assessee:** The AO should familiarize himself with all possible sources on internet/ social media which will enable the AO to understand the scale and extent of the assessee's wealth. This will also be helpful in case of tax recovery matters.

CHAPTER

2

Clues and Their Follow-up

1. CLUES

1.1 Detecting vital clues is the most important part of investigation. An AO has to develop qualities without which it may not be possible to pick up clues which may even be lying on the surface:

i. **Observations and Deduction:** The AO should ever be alert for detecting fraud and for finding out methods of proving fraud. For example, suppose one is examining the expense vouchers, he need not merely look for fraudulent invoices. A printer's bill is in itself an innocuous document but it may also indicate a sales invoice book supplied for a serial number which has not been produced before the officer.

ii. **Imagination:** The officer should constantly visualise what primary records a business man would require; to what methods of frauds it lends itself and how to establish these frauds by reconstructing the modus operandi of the fraud. For example, a voucher for rent of some obscure premises is of no interest in itself but it may start one thinking whether any goods were stored there and whether these goods find a place in the stock sheets.

iii. **Tenacity:** Tenacity in the face of reverses and disappointments, and a refusal to be sidetracked from a promising lead are the surest way to success.

iv. **Intuition:** There is a danger in investigation work-the occupational hazard as it were of investigation-the danger of not seeing the wood for the trees. One cannot exhaust every possibility because investigation would otherwise become interminable.

v. **Use of Technology:** The officer should constantly be updated with News Feeds, Twitter, Facebook, LinkedIn, etc. so as to understand the emerging trends and transaction deals. Regular visits on the regulatory websites *viz.* RBI, SEBI, NCLT etc. also reveal the action taken by regulatory body against companies. Also, MCA website can be a good search tool for finding bogus companies and directors linkage with other Companies, generally used to create a maze structure.

1.2 Clues can be in the books of account as also outside the books of account. The types of

clues that one is ordinarily likely to come across while examining the books of account would be as follows:

Credits

i. Where cash actually comes in and is accounted for in the books of account.

ii. Where cash does not come in at all but credits in personal accounts appear to balance the bogus debits in the various accounts such as purchases, wages, expenses, etc.

Purchases

i. Purchase may be bogus i.e. the goods may have not come in but debits for purchases may have been made, in cash or credit.

ii. Purchases may be genuine so far as the incoming of material is concerned but the price may be inflated by way of

Expenses under various heads being either bogus or inflated or personal.

There may be suppression and/or understatement of sales.

Stocks might be undervalued or suppressed through omissions as obsolete or unsaleable.

There may be payments of secret commission.

The clues may appear in the form of erasures or overwriting. When accounts are being manipulated on a subsequent date, entries are known to have been erased and replaced by convenient entries. Notings of advance years in the cash book may indicate the preparation of cash book from some other record after the close of the previous year. In today's digital era, even the smallest traders have started using accounting softwares to maintain their books of accounts (generally Tally Software is used). The officer should understand accounting system and its constraints in terms of an accounting entry that can be made on a back dated basis i.e. after days/ months or repository of modified entries, etc. The Officer should also look at various management reports which can readily pulled out from the accounting system–in terms of cost variation, TDS reports, cash transaction beyond a particular limit, etc which shall provide ready information to the AO to identify gaps for further inquiry.

Regular agencies have sprung up issuing bogus 'sales vouchers', for nominal commission, to the intending "purchasers". In the hands of the alleged purchasers these amounts are debited as 'purchases' and profits to that extent are reduced. Since the alleged seller is an existing person, often also assessed to income-tax, it becomes difficult to challenge the alleged purchase unless elaborate enquiries are made. Without these the Department may at best succeed in assessing a certain percentage of these alleged sales in the hands of the 'seller'. The result is that the profits to the extent of the alleged purchase escape taxation, while in the hands of the seller only a portion comes up for taxation. Very often the alleged sellers are small parties, and recovery of even this tax becomes difficult. Statements can be recorded of the alleged partied and then a show cause can be issued to the assesse for proving the genuineness of the purchase transaction, which in all practical circumstances would be difficult and hence, the same will attract disallowance *u/s* 37 of the Act and other penal consequences. The information of the accommodating parties can be sourced on real time basis by interacting with other Government Agencies (Revenue Department (GST, Service Tax, Customs), RoC, etc) as well as by obtaining information from the informers. The sharing of such information within the Department is critical since one such parties would be providing accommodation entries to various taxpayers across jurisdiction. The entries in respect of such transaction are not only booked on the purchase or expense side of the Profit & Loss account but are also clubbed with inventory cost or plant & machinery cost to create difficulties in identifying the same.

Exemptions/ deductions claimed by the assesse always require a deeper probe. For example, deduction claimed under Section 10AA of the Act or any other Section requires an assesse to furnish cost allocation between the eligible unit

and non-eligible unit. Hence, the officer should vigilantly check the basis of allocation of cost. Additionally, the Assessing Officer should also verify the transaction details with related parties in case of entity claiming exemption/ deduction since the transaction value could have been manipulated.

Provision for various contingent liabilities should be checked as to whether the same has been prepared based on some scientific basis or not. For example, provision for warranties, etc. While the Hon'ble SC has settled the principle but it is not necessary that the principle is squarely applicable to each case since the facts and the basis of making the provision varies. Important point is to ask for actual expenditure incurred in subsequent years and understand the% variance vis-à-vis the provisioned amount and also to understand the basis for making the provisions i.e., whether it's on an ad hoc basis or based on some industry benchmark.

It has been seen that many assesse nowadays make payment to the overseas holding company in the form of 'Management Fees'/ 'Royalty', etc. The officer is required to probe into same and ask the assesse to establish the need-benefit test for making such payments since it could be a modus operandi for routing the profits outside India. Such expenses should be disallowed under Section 37 if the same are not incurred wholly and exclusively for the purpose of business.

It is seen that in case of service contracts with the overseas parties, the assessee agrees that TDS cost if any shall be borne by the assessee. To avoid the requirement of deducting TDS, it is observed that the assessee interpose an overseas company (within the Group) and such Group Company shall make the payment to the actual beneficiary. Thus, the assessee first makes a payment to the overseas group company who remits the same amount to the actual beneficiary. With this, the assessee takes shelter of the argument that the amount remitted to the Group Company is nothing but reimbursement of expenses and hence, tax is not required to be deducted under Section 195 of the Act. However, if the transaction is seen in substance, interposed Company is nothing but a pass through entity and hence, on an end to end basis, the assessee in fact was required to deduct tax at source.

The officers should analyse the AIR information very cautiously for a proper reconciliation of sales turnover reported by the assessee under other Acts vis-à-vis reported under the books of accounts prepared for income-tax purposes. Even, the information reported by the Banks *viz.* any outstanding loan and corresponding interest paid by the assesse, any investment in the form of fixed deposit and corresponding interest earned on the same should be reconciled.

Tax Deduction at Source remains a key source of Revenue for the Department – it is seen that in case the payer had to bear the TDS, he would generally find a reason to either not deduct TDS or deduct it at a lower rate. The Assessing Officer during the course of assessment or spot verification should essentially ask the taxpayer to furnish expenses-wise, party-wise TDS date for verification. If accounting system is a constraint the same should be called for transaction basis the Assessing Officers selection of sample. If any discrepancies are found and additions are made, the information should also be passed on to the TDS wing for appropriate action under Section 201 of the Act.

The officers should call for documentary evidences to check whether the overseas group company who is in receipt of the payment is the beneficial owner and has substance in the Country where it resides since very often the taxpayer indulges into treaty shopping to claim advantage of lower tax rate under the Tax Treaties (for e.g Mauritius, Netherlands, Cyprus, etc).

General Anti Avoidance Rule ('GAAR') provisions has been introduced from 1 April 2017 with the intent to tax transaction where the main motive is to avoid payment of tax by adopting colourable devices or shame restructuring arrangements.

Hence, all Corporate restructurings *viz.* merger/ amalgamation/ slump sale, etc should be closely scrutinized to determine the drivers of such restructuring i.e., whether the restructuring was for bona fide commercial purposes or the main motive of such restructuring was to avail tax advantage. The tax advantage may not be visible for a standalone transaction but could be traced if the entire arrangement/ transactions spreading across years are looked at together. GAAR is an important tool in the hands of the Assessing Officer to recharacterize the transaction and impute tax demand on the assessee. The same should be used only when the case merits basis the documentation collated during the course of scrutiny or survey.

The officers should always examine the tax neutral/ exempt transaction in connection with merger/ demerger/ holding to subsidiary transfer or vice-a-versa etc. from the perspective of satisfaction of tax neutrality conditions which spans over a period upto 8 years – since if the conditions are not satisfied the benefit/ exemption claimed by the taxpayer can be taxed under the claw-back provisions. In certain cases of merger, it is observed that the assessee uses it as a tool to claim set-off of losses of the amalgamating companies without satisfying the year on year condition prescribed under Section 72A of the Act.

Base Erosion Profit Shifting ('BEPS') is the project initiated by Organisation for Economic Co-operation and Development ('OECD'). The reason this project was initiated was that the global companies has been adopting treaty shopping which helps the global companies to reduce the tax incidence. The said organisation has come-up with Multi-lateral Instrument ('MLI'), to which India is also a signatory. The MLI when comes into force shall change the treaty interpretation substantially tightening the requirement of substance and plucking the loop-hole existing in current treaty provisions which provides the taxpayer advantage of double non-taxation. It is pertinent that the Assessing Officer should keep himself/ herself abreast of the development in this area and ask questions around satisfaction of the condition/ onus casted on the taxpayer through MLI. It is seen on ground that the Assessing Officer in case of assessment of non-residents would not probe into their presence through dedicated agents or its employees in India. Such presence creates a tax incidence for non-residents which goes untaxed. Hence, the Assessing Officer should study this subject carefully and ask the right questions to determine the taxability of non-residents in India.

Recently, Place of Effective Management ('POEM') provisions have been notified, followed by CBDT guidelines on how the POEM for non-residents in India needs to be determined. For a Multinational group (Especially Indian MNCs) having subsidiary outside India, the Assessing Officer should assess compliance of CBDT Guidelines with respect to such subsidiaries.

Till date, the Companies were required to follow Indian Acounting Standards. However, the Companies are now required to align towards Ind-AS which is adoption of global accounting standards/ IFRS. Ind-AS is being made mandatorily applicable to Companies by Company Law/ ICAI in gradual manner (with FY 2016–17 being the start year). Accordingly, until the Tax Audit Report is modified to report the details of any notional expense/ income entries required to be accounted for by the Ind-AS, the Assessing Officer should closely examine this aspect in the course of assessment.

Travel expenses can be checked carefully with proper reasons as to such travel was genuinely needed considering the business model of the assessee or some personal travel expenditure has been captured into travel expenses.

Investments/ receivables/ payables to and from a company can be checked with the help of MCA website as to whether the directors are common or the company can also be a shell company and the transactions entered into may be bogus.

There should be repository for all audit objections raised by the internal revenue audit team so as to

curb the practice of repetitive mistakes and avoid any re-assessment/ rectification proceedings.

The officers should get in touch with the officers in other locations handling similar taxpayers and understand the nature of scrutiny points and additions made by them, being sustained by the Appellate Authorities. The Assessing Officer should explore the strength of knowledge the Department internally possess extensively.

Given that Now-a-days fewer cases are referred to transfer pricing officers, the Assessing Officer should be in touch with the transfer pricing officers to understand whether the assessee is actually transacting at arm's length with related entities.

It is not possible to enumerate all the fraudulent practices because within a certain framework they can be varied in a number of ways.

1.3 The transactions which are altogether outside the books, would ordinarily be either in the form of investments or expenses.

Investments: These may be in shares, securities, national savings certificates, prize bonds, Post Offices deposits, gold bullion/ jeweller, investments in lands and buildings, in other companies etc. in own names or in the names of family members, nominees etc.

Expenses: Secret wealth, if not invested, is bound to be utilised for unrecorded personal expenses. Where accounts are maintained personal expenses are usually written in lump sum without details as to their exact nature. Where no accounts are maintained, personal expenses are estimated at a ridiculously low figure. It is, therefore, necessary always to obtain a break-up of household expenses as completely as possible, particularly when they are unreasonably low. Expenses on education, clubs, travelling-particularly air travel, foreign trips, major ceremonies, credit card payments etc. are usually the items to be checked.

Losses: Many assessees depress the book results by debiting "bogus losses". The technique is simple: say, a builder has earned profit of Rs. 1 crore which he cannot conceal. He then proceeds to reduce the profits by claiming bogus losses in share transactions etc. All he needs is to find an unscrupulous broker who will issue bogus vouchers of purchase and sale over certain period of time resulting in the desired amount of losses. This method is separately discussed in detail in a subsequent volume dealing with transactions on stock exchanges. Suffice it to say that such claims require detailed investigation.

2. FOLLOW UP

2.1 Organisational Setup

Before an AO starts investigation, study of assessee's organisational setup is necessary. When dealing with a vast business, say a textile mill, it is useful to ascertain the duties of each person in-charge of a particular Department, the type of work that he does, the records that he maintains etc. and to follow this up in a logical manner from the point of inward entry of raw material to the outward dispatch of goods - both from the point of view of production and accounting. This may appear time-consuming but it is not. Each organisation tries to develop its characteristics depending upon its needs etc. Therefore, an officer examining two textile mills may have to resort to two different approaches.

In the case of a textile mill while studying its organisation setup it appeared that the mill was paying on piece-work basis for packing of cloth bales. There were regular fortnightly bills showing the number of bales packed every day, their serial numbers and the amounts paid. Each bill was of a very small amount and therefore unimportant by itself, as far as the expenditure aspect was concerned. But it had a different potentiality. If according to these bills it was found that 100 bales had been packed, the logical step would be to see if these 100 bales had been accounted for in the bale register and later in the sales. This was an important clue which was found as a result of the study of the organisational setup. When these bills were cross-checked with the bale register, it was noticed that for some years

the production as per the bills tallied exactly with the production as per the bales register, but after some time the two figures started differing. Every figure in the bale register was found less than that shown in the piece-worker's vouchers. This continued for some time and again the figures in the register and the vouchers started agreeing. This established understatement of production to the extent of the difference in bales as per vouchers and as per the bales register. Any clue, howsoever, simple has got to be followed up to its logical conclusion in all possible ways.

Study of organisational setup also enables the determination of line of investigation and identification of the weaknesses of the assessee's possible defence. The AO should try to see whether the weak points have been exploited by the management or these are only the outcome of the management's inefficiency. Say for example, it is found that the store-keeper is a person in the absolute confidence of the management. The question would be: why? The answer by the management would be that they would have necessarily to put a man in their confidence to keep check over the disposal of stores. This is one aspect of the situation; the other being that the presence of a man in their confidence could also be exploited by the management to take away stores, dispose them of in the open market and yet debit the accounts for the same as consumed. This would only be a clue, to the investigator who would, therefore, switch on his energies to the examination of consumption of stores. If the management wants to resort to manipulation they would take into confidence as few people as possible. The issue slips in such cases could be traced possibly to the confidential person. One may possibly trace his notes in the preparation of the slips. Probably the slip books utilised by that man would be altogether separate from those utilised by other clerks. These slips may not have gone through all the checks to which a slip issued by an ordinary clerk, would be subjected. Aspects such as these ultimately lead to the establishment of bogus debits for consumption of stores.

The study of organisational setup includes the study of the office routine; the maintenance of inward and outward registers, the manner in which the correspondence is filed, and the manner of indexing the files etc. It would involve study of the various Sections, the list of the members of the staff in important Sections such as accounting, purchase, sales, stores, gate-keepers etc., a study of the various family members and persons in-charge to see how and where and in what position they are employed. How each aspect can have vital bearing on the investigation is illustrated by a case where the assessee produced certain letters to show the possession of wealth by him at the time when he started business. This was a certificate given by the Presidency Magistrate to the effect that he had verified the wealth of the assessee as stated therein. According to the assessee, this certificate was forwarded by him to various military authorities. It would have certainly been a Herculean task to rebut this evidence. However, the study of the inward and outward correspondence registers indicated that all the letters before the date of receipt of the certificate from the Presidency Magistrate and thereafter were entered in the inward register but this letter was nowhere to be found. The same was the case in respect of the outward register. It, therefore, became easy to establish that the certificate was not issued on the date on which it was purported to have been issued. Of course it required skill to establish this, but at the material time a vital clue was picked up which helped establishing a substantial fraud with little effort. It did need skill but not much of time or effort. Skill, because the organisation was studied closely and it was noticed that the assessee maintained a perfect system of inward and outward correspondence.

In another case, a study of the capital block namely machinery showed that the assessee had setup a welding generator sometime ago, and six months later a debit was found for a lakh of rupees in respect of welding charges paid to a firm with an impressive looking name. The

organisational record showed that the assessee was having a welder in his employment and apparently there was no need for paying labour charges of a lakh of rupees for welding work. This point, therefore, required a probe. The matter was fully investigated and it was proved that the debit of Rs. 1 lakh was fictitious.

2.2 A Golden Rule

A golden rule for picking up clues is to look for the abnormal and the unusual. An enquiring mind would certainly look for reasons for the deviation. Generally, this could be achieved by doing a review of the financial statements of the assessee. The general principle is that a normal person behaves in a normal way unless there is a motive force to drive him out of that course. When a person goes for overdraft to the bank, the banker insists on security. When a person makes payment he wants receipt. When a loan is repaid the promissory note is returned or when a loan is advanced a promissory note is taken. Exceptions to any of these and similar deviations from normal commercial practice, should always be enquired into. In a case where the bank had given substantial overdraft and the assessee claimed it to be a clean overdraft, a query was addressed to the bank. The skill lies in the manner of making enquiry. If the query was worded in a vague fashion as to whether there was any security against which the overdraft had been granted, the banker would possibly have given a vague answer and the nature and type of security would never have come to light. However, it is not normal a behaviour for a bank, and one can rightly presume that there must have been a security against which the overdraft was granted. An attempt has, therefore, to be made to find out the truth. Sometimes a statement on oath of the banker may serve the purpose. Sometimes one may have to go through the security registers to know the collateral security. In the case referred to above, collateral security in the form of gold had been lodged with the bank in different names other than of the assessee. It was known to the bankers but in the assessee's books there was no mention of the security. An enquiry about the whereabouts of these persons made the bank authorities to admit that the overdraft was granted against the collateral securities lodged by the assessee with the bank.

In another case payments were received from a businessman by cheque from a person say "A". Scrutiny showed that the cheques were of running serial number though they were received on different dates, separated by months. This appeared to be contrary to the normal behaviour of a genuine party, because he would be drawing a number of cheques in favour of other businessmen as well. Therefore, the assessee could never be receiving a cheques bearing running serial numbers. Therefore, a probe was made. It emerged that A's account was started by the assessee himself. His modus operandi was that he would make sales at a low rate to 'A' and thereafter show sales at substantially higher rates as if made by 'A' thus accounting for a part of the profits in his account books while taking away large amount of it through A's account. So far as he was concerned the stock would completely tally and payments, having been made by cheques, create an impression that the party was genuine. If the AO was not alert to notice the continuity in serial numbers and draw logical inferences he would have failed to locate the dealings of the assessee.

The abnormality or the departure from the normal behaviour can appear in many ways. It is not possible to make a list of all such cases. What is necessary is that a person should know what is common behaviour and anything that does not fit into the course of the common behaviour is treated as not normal. And if it is not normal, an enquiring mind will look for the reasons for this abnormality and very likely the officer will find a manipulation on the part of the assessee.

It is possible to focus on the abnormal and the deviant, only if the AO is acquainted with the normal commercial practices in a particular

trade. In this age of information technology and rapid changes in organisational methods and commercial practices every AO must keep himself abreast of them.

2.3 Psychology of Assessees: In order to determine the line of investigation, it is useful to understand the assessee's mental make up, his social standing and his approach to life, which in other words means, his complete psychological make up. This analysis could be made with reference to the person's background, his education, whether he is rich by birth or is a self-made man. Some assessees not only conceal profits but are bold enough to utilise them for investments. Such persons take chances and often get away with it. Some other assessees do not mind assessments or settlements of their income ultimately, but resist actual payment of tax. Others, with high sense of reputation and dignity, would resist the assessment itself, because once an assessment is made the recovery proceedings start and that would endanger their reputation and social standing.

The first category of people may introduce their secreted wealth as bogus loans in their books of account or may invest in shares in bogus names and with these funds start new industries. They are taking risks in regard to these cash credits which if disbelieved would be added back to their income. They would then have an opportunity of contesting before the various appellate bodies and ultimately of running up for a settlement. Even after the incomes are settled, they would resist the payment of tax. In these case, one is almost certain that the secreted income is ploughed back in one form or the other. The usual forms resorted to are loans, cash credits, sales of gold and jewellery, investments in bogus names, investments in properties wherein secreted profits are ploughed back by understating cost of construction, by taking overdrafts against collateral securities standing in different names. In all these cases, by a sustained effort it may not be difficult to establish the concealment. The question, however, that would straightaway arise would be that of recovery. Where bogus loans are added and total income is increased, demand is raised. But there are no visible assets for recovery. These monies once introduced are later taken out and are either reinvested in benami names or are kept in cash, but at the time when recovery is pressed there are no assets on the surface. Thus in cases such as these, determination of concealment is not a difficult job but recovery is difficult. In the case of other category of people, detection of concealment itself would be a problem because here income would be concealed in not too obvious a manner. Thus persons with different mental make ups have to be approached in different ways. In cases of the second category, it would be better to ask for a genealogical tree of the assessee; wealth statements of these persons; a break-up of household expenses, club expenses, holiday expenses and expenses on trips. It is likely that these details will not be provided by the assessee easily, the Assessing Officer should try to indulge into informal talks with the assessee to pull out these types of information. This would probably give information necessary for the assessment of total income. The next item would be determination of doubtful accounts from the group of names Centreed round the assessee's. If a person were to introduce his secreted profits in bogus names, he would select names - even unconsciously-which will revolve round the names of persons close to him. Therefore, it is necessary to obtain a complete genealogical tree of the assessee. Permutations and combinations of names found in this are likely to provide important clues to the benami accounts.

CHAPTER 3

Investments—Statement of Total Wealth

1. In the 'investment' method an attempt is made to find the net increase in wealth of an assessee over several years and compare it with the increase in wealth as disclosed by his books of account and assessments records. Statements of total wealth as on two specified dates are obtained, and the growth in wealth is studied. These statements serve to check whether the assessee has been assessed properly over a period of years. The statements also pin down the assessee's assets and liabilities on a particular date and comes handy on a future date.

2. Suppose the increase in wealth as per wealth statements is 'X' during a given period and increase in wealth reflected in assessee's books of account for the corresponding period is 'Y'. The question arises as to how the assessee came to possess the surplus wealth i.e., X - Y. Further, if the assessee is found to have incurred expenses say 'Z' not recorded in the books, he will have to explain the source of X-Y+Z. His explanation may be that the unaccounted receipts are capital receipts or are receipts of non-taxable nature. These items will be deducted if the explanation is found correct and the balance only will have to be considered.

In other words, increase in wealth during the investigation period is determined by deducting the wealth on the opening date from the wealth on the closing date. To this net increase in wealth, the unaccounted outgoings of the assessee, are added. From the resultant figure, receipts of non-taxable nature e.g., income from agriculture, etc., are deducted. The AO has then to examine whether the net increase so computed could be accounted for with reference to the disclosed incomes.

3. The statement of wealth can be obtained under Section 142 of the income-tax Act, 1961 with the previous approval of the Joint Commissioner. A performa (ITNS 20) has been prescribed for this purpose.

4. GENERAL POINTS

4.1 Before undertaking an investigation, it is preferable to obtain duly verified statements of wealth from the assessee showing his net wealth as on the opening and the closing date of the investigation period. Such wealth statements should also be obtained from persons closely

related to him, and those of his associates, relations, or business contacts suspected to be his nominees or benamidars.

4.2 While obtaining the wealth statements, it is essential to value the assets on cost and not market price.

4.3 While filing wealth statements, assessee may try to inflate the wealth as on the opening date. This may be particularly so where action under Section 147 has become barred by time. The scrutiny of wealth on the opening date, therefore, is of prime importance. The assessee will usually try to overstate his assets like cash, jewellery, and reduce loans payable etc., in this statement.

4.4 There are various sources available today vis-à-vis past with the advent of internet and technology. The same should also be explored and documented before pursuing any taxpayer. Such information can be collated from the internal sources (like Project Insight, AIR, etc) and from external sources (like News Article, You Tube Videos showcasing Wealth of a Celebrity, Twitter, etc).

5. In computing the net increase of wealth, certain pitfalls are to be avoided. It is necessary to scrutinise these statements to check:

- Overstatement of Assets and understatement of Liabilities in the statement as on the opening date.
- Understatement or omission of assets and overstated or bogus liabilities in the statement as on the closing date.
- Any bogus and/ or overstated non-taxable receipts during the intervening period.
- Omission and/ or understatement of expenses and outgoings during the intervening period.

The scrutiny can be made separately for the assets and liabilities appearing in the account books, if any; and those outside the books. So far as the books of account are concerned the net wealth will be reflected in the capital account but all the same there may be fictitious credits on the liabilities side. Similarly, although newly constructed or newly acquired immovable or other properties may have been reflected in the books, their cost may have been understated. In cases requiring detailed investigation, these assets and suspicious liabilities will themselves require proper scrutiny before accepting the capital shown in the books. In respect of assets and liabilities appearing outside the books such a scrutiny is more indicated.

6. ACQUISITION OF WEALTH IN THE INVESTIGATION PERIOD

6.1 Immovable Property

A part of concealed income may have been used in construction of residential and other immovable properties. A reduced value may be shown in the account books or in the wealth statement.

6.1.1 New Constructions

In cases of new construction, it would be useful to inspect the property to have an idea of the cost of construction. Enquiries can be made from the Municipal Corporation regarding the date of passing the plan, the dates of commencement and completion of construction, plan of the building, Municipal valuation etc. Thereafter the assessee can be asked to furnish details of construction. Cost incurred in different accounting years and on different items of construction e.g. bricks, cement, timber, iron, labour, sanitary and electric installations, lift, furniture etc should be classified. After ascertaining the total plinth area, the AO should find out the average disclosed cost of construction per sq.ft. and compare this with the cost shown in comparable cases, as also the relevant CPWD rates. If need arises, the Assessing Officer should summon the construction service provider/ vendors engaged by the assessee for the work to cross check the details.

Where persons concerned have control over a company, there is the possibility of diverting a part of the construction expenses to the books of the company. Therefore, in appropriate cases, account books of the company should also be examined. In one case, a textile mill owner had constructed a building worth Rs. 13 lakhs. The account books maintained by him showed an investment of only Rs. 600,000. Reference to certain reputed suppliers of sanitary and electrical fittings showed that, in respect of two items alone, the firm had supplied services and materials worth Rs. 3 lakh to the assessee. In the firm's books there was an account in the name of the assessee in which these items had been debited. It was, however, found that only a fraction of the amount due to the firm was paid by the assessee from his personal funds. At the instance of the assessee, the balance amount due from him was transferred to the account of the company in the firm's books. The company subsequently paid this. A glance at the firm's ledger folio in the company's books did not reveal any identical credit in favour of the firm but on scrutiny it was found that, in the company's books, the firm was credited with smaller amounts on four or five occasions spread over three years towards alleged purchase of certain stores and articles by the company. The total of these amounts equalled the amount due from the assessee. There was no supply of stores at all by the firm to the company nor did the registers maintained by the company's storekeeper show the receipt of such stores in the godown or their issue to the manufacturing department. When the matter was pursued it was found that items like masonry charges, carpentry charges etc which related to the house construction of the assessee were debited to this account Ultimately, the assessee came forward and admitted the real cost of the house constructed by him. This instance shows the way understatement of construction is resorted to by persons having control over companies.

6.1.2 Purchase of Property

Where property is acquired by purchase, the conveyance is made by a registered document. The assessee will show the purchase price as shown in the registered deed. But it is common knowledge that sometime the buyer and the seller in collusion agree to show in the deed a reduced amount of consideration to save stamp duty and registration charges and also to save the vendor from assessment to capital gains tax (or to income-tax where the vendor is a dealer in real estate). The purchaser may not show in his books the extra amount paid by him to the seller. These aspects should be kept in view before accepting the purchase price of newly acquired house properties. This can be verified by the ready reckoner rates of that particular sub-registrar. In case the reckoner rates are higher than the rate mentioned in the agreement, the Assessing Officer should investigate it further. Additionally, Information can be collected from the Builder to understand at what rate the flats has been sold to others to understand involvement of on-money.

6.1.3 Purchase of Property in Foreign Land

If this information is not disclosed, finding this information would be challenging. The Assessing Officer will need to analyse the financial statements of the assessee minutely and probe the assessee to pull out such information, if any. The subsequent challenge would be to find out the value of investment. The Assessing Officer will need to act appropriately in such situation to gather maximum information from the assessee. Additionally, the Ministry of Finance has strengthened the Treaty with other Countries which also provides for Information exchange Clause under DTAA. The Assessing Officer should certainly make use of the same (through proper channel) and collate the information from other jurisdiction.

It should also be seen whether there had been large scale renovations to an existing property.

This would be indicated by the increased income yield without any apparent increase in investments. If the property was subjected to an initial charge by way of mortgage, the manner in which it was cleared should be looked into. Similarly, insurance policies, if any, should be scrutinised to have an idea of the value at which the property has been insured to check the reasonableness of the value declared by the assessee. In respect of house sites and agricultural lands, apart from verifying the correctness of the purchase price, the extent of improvement and development carried out should also be ascertained through local enquiry.

6.2 Movable Properties

6.2.1 Shares and Securities

Where shares and securities are disclosed in the wealth statements as owned on two specified dates, a statement of the shares and securities should be drawn up with reference to the assessment records, and dividend warrants received in the period between the two dates on which the wealth statements have been called. These should be compared to see that the sources of assets disclosed in the assessments have been incorporated in the wealth statements, as shares and securities held for short periods in between the investigating period would not find a place in the wealth statements and it is quite likely that the source of moneys invested in them is kept outside the wealth statements filed.

Concealed income is usually invested in shares in the names of wife, minor children or even some benamidars. If the investment in shares has been made in those companies which do not belong to the group of the assessee, it may be difficult to find out such benami investments, unless some outside information is received. It is quite probable that most of the investments in the share capital are made in the companies belonging to the group of assessee himself. From such companies the following information should be gathered:

- Names and addresses of the persons who applied for shares.
- Names and addresses of the persons to whom the shares were allotted.
- The date of payment of share capital on application and on calls.
- Mode of payment i.e. whether paid in cash or by cheque.
- If paid by cheque, the bank on which the cheque was issued and name of the person who issued the cheque.
- Whether any change has been effected in the shares from the first allotment. If so, names and addresses of the persons who bought the share subsequently, should also be obtained.

Usually, application money is sent along with the applications for allotment of shares,. If the shares are not allotted, these amounts are returned. If the applicants are from places away from the registered office of the company, the amounts would usually be remitted through bank drafts. On allotment of shares the company would send information to the applicants and would subsequently receive call money through bank. If the shares are not allotted, the money would be refunded by the company through bank. Bearing these broad features in mind, the AO should make enquiries about suspected parties. With the dematerialisation of shares the relevant information can now be obtained from the Depository Participants (DP) or preferably from the Depositories as all the transactions of transfer of demat shares are recorded by the Institutions.

In a group of cases investigations about share capital showed the following results:

- A number of new shareholders were all residing at stations away from registered office of the company.

- All of them signed share applications on the same date and these were received in the registered office of the company on the same date.
- The share applications showed that they were written by the same person although signatures were in different names.
- All persons who applied for shares were allotted the exact number of shares for which they had applied.
- All the money on application and calls was paid in cash.
- Dividends were also paid in cash by the company to the shareholders.
- Letters sent by the investigating officer to the alleged shareholders, were returned by the post office with the remarks "not known".

When the assessees were confronted with these facts, they accepted all the investment as their own.

In some other cases it was seen that shares of newly floated companies or even old shares were purchased through disclosed funds. Subsequently, these shares were shown to have been sold to some persons and usual transfer entries were made in the books of the company. The sale price realised from the alleged purchasers was thus brought back in the books. On enquiries, it was seen that the alleged purchasers were benamidars of the assessee and the alleged sales were never made. The amounts introduced in the book in the garb of sale of shares were mere introduction of secret accumulated profits. In one case, during a search a large number of such share scripts were found in the house of the assessee with blank transfer memos duly signed. All these shares were shown by that assessee to have been sold earlier and sale proceeds were brought in the books.

Special attention is required in respect of shareholders and investments made by Shell Companies. The Ministry of Corporate Affairs have tracked and declared the Companies which falls under this Category. Shell Companies have been used by many Hawala Traders to convert the illegal/ black money of affluent people into white by making investments at premium and then selling such companies at a throw-away price. The investments are then sold at cost by the purchaser and the entire sales proceeds is accounted without any tax incidence. The money received on sale of investment is nothing but the cash of the purchaser which is unaccounted and untaxed.

6.2.2 Movable Properties–Vehicles

A statement of vehicles owned in the name of the assessee, spouse, children, parents or even some benamidars should be drawn-up. Usually, when the assessee has concealed certain income, it is likely that he purchases vehicles to match-up with his status in the society. These vehicles may be correlated with his declared income.

Additionally, it is seen Now-a-days that some people also purchase their private aircraft or a yacht. The value of such aircraft/ yatch may be found and correlated with his declared income.

Although finding details of the ownership of vehicles is a difficult task, the Assessing Officer may try to connect with the regional transport offices to find out the number of vehicles owned by the assesse and the vehicles having registration details matching with the address of the assessee. Similarly, the aircraft/ yacht are also required to be registered with the Directorate General of Civil Aviation/ Directorate General of shipping respectively. Accordingly, these information may be pulled-out from these government bodies including online sources.

6.3 Cash

Opening Wealth statement may indicate large cash to cover up the subsequent investments out of concealed income. Therefore, cash shown in the opening statement must be accepted

with great caution. For this purpose, it may be necessary to have an idea of the total income of the assessee for the period prior to the opening date and also the investment and expenses of the assessee for that period. Circumstances such as, the assessee borrowing heavily during that period, or seeking time even for payment of small taxes on ground of financial difficulties, or drawing from his personal account or from his bank account for household expenses, or making periodical deposits in bank, or selling jewellery and other assets for discharging liabilities, may indicate that the story of availability of large cash at the beginning is fake.

On the other hand in the closing wealth statement the assessee may not show any cash at all or may show nominal amount. Generally, the period of investigation is considered up to the end of last accounting year. A perusal of the personal accounts of the assessee (and also his bank accounts) may indicate large drawings towards the close of the period. If the assessee is not able to explain how the drawings were utilised, the point as to whether such drawings remained with him as cash has to be considered. So also, if there have been sale or realisation of investments not shown in the wealth statement, the assessee should be asked to explain whether those remained as part of the cash not disclosed by him.

6.4 Investment in Gold, Jewellery etc.

Often concealed income is invested in gold, silver or jewellery. Enquiry about such investment may prove to be difficult when the assessee has persuaded the jewelers not to keep record of such sales. Therefore, the investigator has to depend upon information from other sources. It is usual to show large quantity of jewellery and bullion in the opening wealth statement while in the closing statement it will be shown at a nominal amount. In such cases an attempt should be made to find out when the jewellery and bullion were purchased and whether the assessee was capable of purchasing or possessing so much. In important cases it may be necessary to get a detailed list of jewellery. The general status and background of the assessee should also be kept in view while judging the reasonableness of the quantity of jewellery and bullion possessed or acquired.

7. LIABILITIES

In the closing statement, the assessee may try to reduce the net wealth by showing bogus liabilities. These may be for purchases and/ or expenses shown to have been incurred in business; or for loans taken from individuals or banks. Enquiries have to be made to see whether these purchases or expenses were actually made or not. If the liabilities are continuing for a number of years, there is every chance that these are not genuine.

As regards bank loans, enquiries should be made about the securities pledged. Only in rare cases banks allow clean overdrafts. The value of securities pledged with a bank is always more than the amount of over-draft allowed. The AO should see whether these securities find place in the list of assets filed by the assessee. In many cases, it has been seen that fixed deposits made in names of ladies or relations or benamidars were pledged with the bank for obtaining over-drafts. Therefore, whenever such assets are not included by the assessee in his list, investigation regarding source and ownership must be made. If an assessee has pledged raw materials or stocks with a bank, the AO should see if the pledged stocks are properly accounted for in the books and included in the list of assets filed by the assessee. The value declared to the bank normally represents the cost incurred by the assessee and in case there is wide variation between the value declared to the bank and the value shown in the wealth statement, suitable enquiries should be made.

The practice of introducing secret income as cash credits in the names of third parties is quite common. Whenever such loans are shown, proper investigation should be made.

8. OUTGOINGS

8.1 General facts such as the status and style of living, spending habits etc. should be ascertained. For determining personal expenses, the following information may be of use:

- The location of the residential house and the rent or municipal taxes paid.
- Number of servants employed for household work.
- Names of the club of which the assessee is a member and the amount of club bills.
- The number and make of the cars owned by the assessee.
- Number of dependent persons and general standard of living.
- Life insurance premium, P. F., donations, taxes etc. paid.
- Payments made to credit card companies
- Number of school-going children, the institutions to which they have been admitted, and the expenses incurred on their education.
- Special facts, such as foreign trips, amount spent on vacations, etc..
- Extraordinary expenses, such as marriages, gifts, donations to charities etc.
- Expenses incurred towards purchase of Crypto-Currency (Bitcoin, etc).
- Spendings on luxury items, such as luxury portable electronic devices, luxury timepieces, luxury writing instruments, super premium beauty and personal care products.

The above information will have to be discreetly collected without giving offence to the assessee. As the information is of personal nature, any over-zealous approach should be avoided.

Where a detailed probe is called for, a list of the marriages and other major ceremonies performed in the investigation period should be prepared and the assessee should be asked to state the expenses incurred in each events on different items e.g. gifts, purchase of jewellery, entertainment, etc. This should be verified by local enquiries.

9. CLAIMS OF NON-TAXABLE INCOMES

9.1 Income from Agriculture

The assessee may show that he possesses agricultural land and receives certain annual income from this source. Usually books of account are not maintained for agricultural income and, therefore, such income can be easily inflated. At present only in some States, there is levy of Agricultural income-tax. The AO should ascertain the minimum amount liable to Agricultural income-tax in the particular State. The claim of agricultural income should, be judged with reference to the amount of agricultural income-tax paid by him.

Where detailed probe is required, it may be necessary to obtain particulars including survey numbers of the lands actually cultivated, the nature of cultivation done, the number of crops, source of irrigation, particulars of land revenue, the details of purchase of seeds, fertilizers etc., the facilities of storage of agricultural produce, the particulars of sale proceeds of the produce and the persons to whom it was sold. It is usually possible to obtain from the land revenue department 'crop statement' in which these particulars are shown. The AO can then make a fair estimate of the agricultural income.

9.2 Gifts, etc.

Often assessees claim that he or his wife or children have received large gifts from their relations. A list of such donors should be obtained along with the amounts of gifts and date of such gifts. Enquiries should be made from the donors whether they have actually made such gifts.

Cash gifts and legacies should also be examined with reference to the payer's ability to make such gifts. Where the assessee is related to the donor, an enquiry with his other relatives or persons who are similarly placed with reference to the donor, may help to bring out the truth. For instance, when an alleged donor picks up one of his relatives to make a handsome gift other similarly-placed relatives would be aware of it, and if the gift is not true, they may come forward to state the truth.

9.3 Sale of Ornaments

Some of the investments may be claimed to have been made from sale of family ornaments. If the amount is substantial, details of acquisition of ornaments, mode of sale and person to whom sold, should be obtained for verification of the sale as also the acquisition of ornaments.

9.4 Insurance, G.P.F., etc.

In cases of maturity of Insurance Policy, Provident Fund etc., there should not be any difficulty since these receipts are capable of complete documentary verification.

9.5 Mutual Fund Units

The statement of the units purchase and sold during a year should be called for and verified with the AIR report since Mutual Fund Companies are also required to share the information under Rule 114E.

10. After the above enquiries, the income of the investigation period can be determined by adding out-goings to the net increase in wealth and subtracting the non-taxable income from this figure.

CHAPTER

4

Co-Ordination with Other Enforcement Agencies and Sharing of Information

1.1 Various departments & agencies are working under the Central Government for tackling fiscal offences. Most of these are under the Ministry of Finance (Dept. of Revenue) like income-tax Dept, Central Excise & Customs, DRI, Enforcement Directorate, Central Economic Intelligence Bureau (CEIB etc. Similarly state govt. departments also deal with economic offences under their statutes through their enforcement/ intelligence outfits. However, because of computerisation, faster means of transport & communication and ingenuity of the tax evaders, economic crimes have increased. Only a well-coordinated approach & sustained effort can check their fraudulent activities which otherwise deprive the State of its legitimate dues besides causing irreparable damage to the moral fabric of the Society.

1.2 Financial crimes are growing in sophistication and criminals accumulate significant sums of money through offences such as drug trafficking, investment fraud, extortion, corruption, embezzlement, tax evasion and tax fraud. The nature of financial crime means that the same activity may violate a number of different laws. Different government agencies may be involved at various stages of tackling financial crimes, including the prevention, detection, investigation and prosecution of offences and the recovery of the proceeds of crime. Tax offences are often intrinsically linked to other financial crimes as criminals fail to report their income from illicit activities for tax purposes. Conversely, criminals may over-report income in an attempt to launder the proceeds of crime. In its 2009 and 2010 recommendations, the Organisation for Economic Co-operation and Development (OECD) advocated greater co-operation and better information sharing between different government agencies involved in the fight against financial crimes both domestically and internationally.

2. There are two main agencies/ forum which are responsible for coordination of information in respect of tax crime, which are discussed as under:

2.1 The Central Economic Intelligence Bureau (CEIB)

The CEIB is the nodal agency for economic intelligence mandated to ensure effective interaction and coordination among all the concerned agencies in the area of economic offences. It functions as the clearing house of all economic intelligence and provides a platform for such exchange between various agencies within the Department of Revenue and other intelligence and enforcement agencies including IB, RAW, CBI etc. The main responsibilities of CEIB are as under:

- To collect information on various illegal economic activities and monitor sensitive and susceptible sectors of the Indian economy and financial sector.
- To ensure the full implementation of the Conservation of Foreign Exchange and Prevention of Smuggling Activities Act, 1974 (COFEPOSA). [1] It is also responsible for developing methods to counter such crimes and criminal organisations involved. [1]
- It is the chief coordinator of other agencies in the Ministry of Finance that are responsible for fighting economic offences, as well as the agencies of state governments.
- The CEIB also cooperates at the international level with the agencies of other countries responsible for customs, drugs and economic law enforcement.

2.2 Economic Intelligence Council

The Economic Intelligence Council is the apex forum overseeing government agencies responsible for economic intelligence and combating economic offences in India. The Council is also the apex of 18 regional economic intelligence committees, and is part of the Union Ministry of Finance. Formed in 1990, the Economic Intelligence Council is responsible for coordination, strategy and information-sharing amongst the government agencies responsible for intelligence and control of economic offences such as smuggling, money laundering tax evasion and fraud. The Council also advises the Finance Minister and the Union Council of Ministers on laws regulating the financial sector and fighting economic crimes.

The chairperson of the Economic Intelligence Council is the Finance Minister of India. Its chief members include the Governor of the Reserve Bank of India (RBI), Chairman of the Securities and Exchange Board of India (SEBI) and the Directors of the Central Bureau of Investigation (CBI), Narcotics Control Bureau (NCB) and the Directorate of Revenue Intelligence. Members from the Finance Ministry include the Secretaries of Finance, Revenue, Company Affairs and the Additional Secretary of Banking. The Central Board of Indirect Taxes and Customs is represented by its chairman and its Member responsible for the Excise/ GST, Customs and Anti-Smuggling departments, such as the Directors Of Directorate of GST Intelligence (DGGI) and Directorate of Revenue Intelligence (DRI). The Central Board of Direct Taxes is represented by its Chairman and the Member (Investigation). Other department heads include the Directors of the Directorate General of Economic Enforcement. The Deputy Director General of the Central Economic Intelligence Bureau serves as the Council's secretary. Special invitees include the director of the Intelligence Bureau (IB) and the Directorate General of Foreign Trade.

2.3 Regional Committees

Under the Economic Intelligence Council are Regional Economic Intelligence Committee (Commonly known as REICs). The REIC, formed in 1990, is the apex forum overseeing government agencies responsible for economic intelligence and combating economic offenses in the respective states of India. The Committee is under the Economic Intelligence Council. The head of the committee is usually the Directorate General of income-tax (Investigation). There are regular meetings of REIC from time to time.

It is the platform where the different agencies discuss/ share with each other.

3. OTHER ENFORCEMENT AGENCIES

3.1 As already discussed, various departments & agencies are working under the Central Government for tackling fiscal offences. Most of these are under the Ministry of Finance (Dept. of Revenue) like income-tax Dept, Central Excise & Customs, DRI, Enforcement Directorate, Central Economic Intelligence Bureau (CEIB etc. Similarly, state govt. departments also deal with economic offences under their statutes through their enforcement/ intelligence outfits. A brief outline of some of the agencies is as under:

3.2 Directorate of Revenue Intelligence (DRI)

The Directorate of Revenue Intelligence (DRI) is India's chief anti-smuggling intelligence, investigations and operations agency. The Directorate is run by officers from the Central Board of Indirect Taxes and Customs (CBIC) who are posted in its various Zonal Units as well as in Indian embassies abroad as part of the Customs Overseas Intelligence Network. DRI is the major intelligence agency which enforces the prohibition of the smuggling of items including drugs, gold, diamonds, electronics, foreign currency, and counterfeit Indian currency.

3.3 Narcotics Control Bureau (NCB)

NCB is the nodal drug law enforcement and intelligence agency of India responsible for fighting drug trafficking and the abuse of illegal substances. The NCB was created in 1986 to enable the full implementation of The Narcotic Drugs and Psychotropic Substances Act, 1985 and fight its violation through the Prevention of Illicit Trafficking in Narcotic Drugs and Psychotropic Substances Act, 1988. Officers in this organisation are drawn from Indian Revenue Service, Indian Police Service and other Paramilitary forces. The Narcotics Control Bureau is also represented on the Economic Intelligence Council.

3.4 Central Bureau of Investigation (CBI)

The CBI is the premier investigating agency of India. The agency has been known to investigate several economic crimes, special crimes, cases of corruption and other high-profile cases. From 1965 onwards, the CBI has also been entrusted with the investigation of Economic Offences and important conventional crimes such as murders, kidnapping, terrorist crimes etc on a selective basis. The Economic Offences Wing of the CBI deals with cases of violation of various economic/ fiscal laws. The investigation in such cases is extremely important for the taxation aspect and thus coordinated investigation becomes very important. Similarly, State police are also having Economic Offence wing for the investigation of Financial/ economic frauds.

3.5 Enforcement Directorate (ED)

The ED is responsible for enforcement of the Foreign Exchange Management Act, 1999 (FEMA) and certain provisions under the Prevention of Money Laundering Act (PMLA). Work relating to investigation and prosecution of cases under the PMLA has been entrusted to Enforcement Directorate. The policy aspects of the FEMA, its legislation and its amendments are within the purview of the Department of Economic Affairs; while policy issues pertaining to PMLA, are the responsibility of the Department of Revenue.

3.6 Serious Fraud Investigation Office (SFIO)

The Serious Fraud Investigation Office (SFIO) is a corporate fraud investigating agency in India. It is under the jurisdiction of the Ministry of Corporate Affairs, Government of India. The SFIO is involved in major fraud probes and is the co-ordinating agency with the income-tax Department and the Central Bureau of Investigation. It is a multi-disciplinary organisation having experts from financial sector, capital market, accountancy, forensic audit, taxation, law, information technology, company

law, customs and investigation. These experts have been taken from various organisations like banks, Securities and Exchange Board of India, Comptroller and Auditor General and oncerned organisations and departments of the Government.

3.7 Authority under Goods and Services Tax (GST)

3.7.1 GST (Goods and Services Tax) is a single indirect tax aimed at making the country a unified common market. It is imposed on the supply of goods and/ or services within India. Multiple indirect taxes that the Central Government or State Governments impose on suppliers and consumers are subsumed by GST. The tax came into effect from July 1 2017 through the implementation of 101th Amendment of the Constitution of India by the Indian government. The tax replaced existing multiple cascading taxes levied by the central and state governments.

The tax rates, rules and regulations are governed by the GST Council. GST Council is the governing body of GST having 33 members. It is chaired by the Union Finance Minister.

3.7.2 "Goods and Services Tax" Network (GSTN) is a non-profit organisation formed for creating a sophisticated network for GST. The portal is accessible to the GST authorities for tracking down every transaction, while taxpayers have the ability of connect for their tax returns. GSTN is wholly owned government company having equal shares of state and central government. As per GST Law, a registration number which will be issued by GSTN (Goods and Service Tax Network), will be PAN based. In other words, now all registrations under GST, whether CGST or SGST, will be linked with PAN. Even earlier, Excise and Service Tax registrations were being linked with PAN but so far State VAT was concerned, they were not connected with PAN. Though State commercial taxes department were asking PAN of taxpayer but their TIN (Trader Identification Number) was not linked with PAN.

3.7.3 As the GSTN is PAN based, the government is planning to compare data filed by companies with different departments to detect discrepancies and check whether there's been any leakage in tax collected, raising the prospect of even greater scrutiny. It will be possible to analyse and synchronise GST returns, income-tax returns and transfer pricing submissions in a manner that hasn't been possible before. The GST taxation system has been divided into two parts–Central GST (CGST) and State GST (SGST). Therefore, for effective coordination the AO has to collect information both from CGST and SGST authorities.

4. SHARING OF INFORMATION

4.1.1 In the course of their activities, different government agencies collect and hold information on individuals, corporations and transactions which may be directly relevant to the activities of other agencies in combating financial crime. Mechanisms to enable this information to be shared improve the prevention and detection of financial offences, enable investigations to be conducted more effectively and efficiently, result in faster and more successful prosecutions, and increase the likelihood of the proceeds of crime being recovered. In order for information to be shared, legal gateways must exist between the relevant agencies. Conditions and exceptions can be applied to different forms of arrangement and gateways may provide for different arrangements to apply in different circumstances. Under all types of co-operation with respect to sharing information among different agencies, it is important to protect the confidentiality of information and the integrity of work carried out by other agencies.

4.1.2 Time is of the essence for effectively co-coordinating the enquiries amongst various agencies. If the information is not passed on to the concerned agency on top-priority basis, particularly if such information emanates during the course of a search or survey, it may seriously impair the other agencies' chances of success as it will afford the taxpayer/ offender time to manipulate his books and fabricate the evidence. It would be expedient for an investigator to keep

his superior informed in case he comes across any information having a Customs/ FEMA/ CBI/ Police angle during the course of any operation, so that the concerned officer can pass the same to his counterpart in other agencies immediately. Similarly if during a Police/ CBI/ Customs/ FEMA actions any substantial unaccounted cash or stock or incriminating document is discovered, the same should be promptly verified by the concerned IT authorities. There is thus paramount need to have effective liaison with the various enforcement agencies so that all the agencies are able to effectively implement the law being administrated by them.

4.1.3 Generally speaking co-ordination with other departments (both Central & State) can achieve twin objectives:

i. Dissemination of information by other agencies which may be beneficially utilised by the income-tax Department,

ii. Dissemination of information by an AO/ Investigator to other agencies.

4.2 Dissemination of Information Collected during Assessments

During enquiry/ assessment proceedings an AO may come across some evidence/ information indicating a person's involvement in some fraud or commission of some economic offence. Though initial enquiry by the AO may not directly establish offence, but it may provide useful material to pursue the matter by other departments. Some of the common points which are noticed during assessment proceedings are as under:

- Bogus purchases booked from fictitious entities.
- Bogus Balance Sheets are furnished to banks with a view to get enhanced credit limits.
- Turnover is inflated to hoodwink the credit institutions.
- Bogus export claim in preferred for claiming various incentives.
- Production of goods is suppressed to evade excise duty.
- Turnover is not fully accounted to evade sales tax.
- False certification by CAs/ Auditors etc. in statutory audit reports.
- Bogus profit/ loss due to manipulation of shares transactions.
- Transfer pricing adjustments.

In cases where proof exists of such malfeasance, information needs to be communicated to the concerned authorities through appropriate channels.

4.4 Dissemination of Information Collected during Searches etc.

During the course of searches if some information is received or document found which shows any offence under the Customs, GST, FEMA, PMLA, Police or Anti-corruption laws, the information needs to be quickly passed on to the control room so that it could be expeditiously transmitted further for enabling the concerned agency and its officers to verify the information at a very early stage. CEIB is now the nodal agency for co-ordinating and strengthening of intelligence-gathering activities by various agencies concerned with enforcing economic laws. Though CEIB has setup data banks but as collation and communication through CEIB may take time, an immediate communication with other agencies during search or investigation is of paramount importance to facilitate timely action by those agencies.

4.5 Legal Aspect of Sharing of Information

4.5.1 Information by income-tax are held by the Department in a fiduciary capacity, hence the Department owes a bounden duty to ensure

that personal and confidential information of a tax payer was held in the safest and secure manner. Thus, while sharing information legal aspect requires careful examination. Discloser of information in respect of the assessee is governed by Section 138 of the IT Act 1961. The CBDT has issued various notifications under Section 138 from time to time. The AO should examine these notifications issued before sharing the information.

4.6 Sharing of Information under RTI

The information of the assessee routinely cannot be shared with anyone under RTI as details disclosed by a person in his income-tax returns are "personal information" data, which is held in "fiduciary capacity" and stands exempted from disclosure under Clause (j) of Section 8(1) of the RTI Act, unless it involves a larger public interest. The Supreme Court and various High Courts have often denied disclosure of IT returns. The Supreme Court in *Girish Ramchandra Deshpande vs. Central Information Commission & others* held that the details disclosed by a person in his income-tax returns are "personal information" which stand exempted from disclosure under Clause (j) of Section 1)8) of the RTI Act, unless it involves a larger public interest.

> *"14. The details disclosed by a person in his income-tax returns are "personal information" which stand exempted from disclosure under Clause (j) of Section 8(1) of the RTI Act, unless involves a larger public interest and the Central Public Information Officer or the State public Information Officer or the Appellate Authority is satisfied that the larger public interest justifies the disclosure of such information."*

As a matter of fact, the AOs routinely deny disclosure of IT returns citing the court judgments and Sec 8(1)(j) of the RTI Act. They often cite "privacy" and data held in "fiduciary capacity" as the reasons for denying information. However, the facts of the case may be examined in detail and the larger public interest examined before taking any final decision in this regard.

5. COLLECTION OF INFORMATION

5.1.1 During Searches by other Enforcement Agencies

Searches by other agencies sometimes result in detection of incriminating documents/ unaccounted assets. What is important is timely communication of information by each agency to the Departmental Officers. Timely follow-up and cross-examination of the concerned person by I.T. Officers on vital points may help the department to build a strong case.

5.1.2 During Recovery Proceedings

Well co-ordinate enquiries and assistance by other agencies may facilitate recovery proceedings. Banks, FIU, Customs and Central Excise, GST Police etc. could be of great assistance to AOs in suitable cases.

5.1.3 During Assessment Proceedings

AOs can collect information from various enforcement agencies which could be gainfully used in selecting appropriate cases for scrutiny/ collection/ collation of relevant data & its proper use. During the course of assessment proceedings such information is often of immense use. Similarly corroborative evidence collected by an independent investigating agency helps the AO to defend his case before the appellate authorities.

5.2 Economic Agencies

5.2.1 Co-ordination with following agencies will be of definite advantage in following types of cases:

Co-ordination with the above departments/ agencies can help the department to have access to enormous data regarding various economic activities in the country. It may serve twin purpose of widening the tax-base & unearthing concealment of Income in existing cases.

Types of Cases	Enforcing Agencies
(a) Corporate assesses	The Registrar of Companies (ROC) Company Law Board (CLB) National Company Law Tribunal (NCLT) Reserve Bank of India Security and Exchange Board of India Various Scheduled Banks. The Serious Fraud Investigation Office (SFIO)
(b) Service Industry	Good and service Tax Authority in States as well in Centre.
(c) Traders	Commercial tax department of states. (In old cases) Good and service Tax Authority in States as well in Centre. Wings of Local Self-Government in-charge of levy and collection of octroi duty.
(d) Manufacturers	Director General Anti-Evasion (Central Excise) (In old cases) Good and service Tax Authority in States as well in Centre
(e) Exporters and Importers	Directorate of Revenue Intelligence Commissioner of Customs (Preventive) Enforcement Directorate Reserve Bank of India Director General of Foreign Trade

5.3 Central Information Bank of Economic Offences/ Offenders

On the direction of Economics Intelligence Council a data bank of economic offences has been setup in CEIB. All the field formations are required to furnish information related to offences booked/ detected since 1991 -92. Cases to be reported should have seizure of more than Rs. 50 lakhs or where the Income is more than Rs. 1 Crore.

For the purpose, a Performa has been prescribed. This data bank in CEIB is responsible for coordinating & strengthening intelligence-gathering activities by various agencies concerned with investigating economic offences. CEIB has prescribed formats, and data entry software to all the agencies to ensure furnishing of information/ data in the standardised formats

Offence/ Modus Operandi by CEIB is as under:

- Misuse of banking channels
- Money laundering through banks
- Money-laundering through hawala
- Investment in real estate
- Benami transactions
- A list of the offences/ modus operands identified
- Use of hawala entries
- Misuse of lncentives under the income-tax Act (e.g. Section 80 HHC)
- Smuggling of contraband
- Smuggling of explosive/ ammunition
- Smuggling of gold through land, sea, or air
- Smuggling of silver through sea, air, or land
- Misclassification of goods
- Under-valuation of assessable value
- Misuse of exemption notifications
- Misuse of various performa credit/ set off/ money credit schemes
- Under-valuation of imports
- Over-valuation of exports
- Drawback frauds
- Import license violation
- Undisclosed investment in shares. FDRs, other securities
- Introduction of black money through bogus creditors/ debtors
- Under-invoicing of sales
- Over invoicing of purchases
- Claim of bogus expenses Capital build-up cases
- Introduction of black money in the books in the form of squared-up loans
- Under valuation of fixed assets
- Wrong claim of depreciation/ Investment allowance
- Creation of capital through gifts in the names of minors/ ladies
- Creation of number of entities to reduce tax

- Misuse of MODVAT schemes
- Suppression of production and unaccounted manufacture
- Clandestine removal of excisable goods
- Wrong or fraudulent availment of rebate, drawback, refund and other export incentives.
- Technical offences under Central Excise & Salt Act not covered above
- Illegal sale/ purchase of foreign exchange in open market.
- Bogus import remittances through false i documents
- Creating NRIs, obtaining power of attorney of their NRI Accounts, selling cheques at premium
- Remittances of foreign exchange through hawala/ Bank TT
- Non-realisation of export proceeds and retention of export proceeds abroad
- Bogus exports for availing VABAL and repatriation of black money as export proceeds.
- Import of gold and silver purchased through hawala
- Carrying of foreign exchange through "Diggi"
- Foreign exchange transactions through Vostro or Escrow accounts
- Cross-border smuggling of narcotics
- Inland smuggling of narcotics
- Clandestine manufacture of narcotic and psychotropic substances
- Smuggling of narcotics through carriers

For overseeing co-ordination at the field level, Regional Economic intelligence Committees are functioning. They meet periodically & discuss the cases being handled by different agencies, which are of interest to others. CEIB not only updates the information on various facets of economic offences and well-known offenders, but assists different departments in quick dissemination of relevant information to other agencies and acts as a focal point for collection of Intelligence on an all India level.

6. ROLE OF FINANCIAL INTELLIGENCE UNIT–INDIA (FIU-IND)

FIU-IND was setup in 2004 as the central national agency responsible for receiving, processing, analyzing and disseminating information relating to suspect financial transactions. FIU-IND is also responsible for coordinating and strengthening efforts of national and international intelligence, investigation and enforcement agencies in pursuing the global efforts against money laundering and related crimes. FIU-IND is an independent body reporting directly to the Economic Intelligence Council (EIC) headed by the Finance Minister.

FIU-IND is the designated authority under Prevention of Money laundering Act, 2002 (PMLA) to receive information from different reporting entities. Accordingly, it has a database of, inter alia, bank accounts and transactions therein, transaction in securities, insurance premium paid on policies etc. FIU-IND shares information spontaneously and on request basis. The Central Board of Direct Taxes and FIU-IND have executed Memorandum of Understanding (MOU) for exchange of information. Therefore, income-tax Authorities under CBDT can seek information from FIU-IND for both domestic bank accounts/ transactions as well as those from foreign countries. Such information may be extremely useful for recovery from bank accounts hitherto unknown to income-tax Authorities or bringing to tax the transactions that might have been done through undisclosed bank account(s). However, strict confidentiality is required to be maintained in handling such information. The CBDT has issued Guidelines on the procedure to be followed for seeking information from Financial Intelligence Unit-India (FIU-IND), which should be strictly adhered to while calling information from FIU-IND. These Guideline were issued by the CBDT vide letters dated 15.02.2016 and 29th September 2011. These are available on the website of irsofficeronline with the link https://www.irsofficersonline.gov.in/OfficialCommuniqueItem.aspx?ID=6536.

CHAPTER

5

Investigation of Computerized Books of Accounts

Investigation of accounts forms one of the core aspects of any financial investigation undertaken by the investigators of the income-tax department. A proper investigation of accounts provides a critical insight into the business model and the income generating activity, which otherwise is difficult to comprehend because of the myriad of transactions. Investigation not only requires basic understanding of the accounts and financial statements but also requires specialized skill sets to deal with the complete digitization of accounts. Thus, in this Chapter we will deal with techniques of investigation of accounts and also cover various aspects of popular ERPs/ digital platforms in which such financial data is maintained and operated by the assessees. An overview of the analytical tools, which may help the investigator in detecting the financial issues/ anomalies/ manipulations/ adjustments etc. for the purpose of detection of tax evasion have also been provided below. Accordingly, this chapter has been divided into four main parts:

1. Investigation of accounts in Tally ERP
2. Investigation of accounts in SAP ERP
3. Techniques of Investigation of accounts
4. Application of forensic accounting for investigations.

1. INVESTIGATION OF ACCOUNTS IN TALLY ERP

1.1 Tally and its Structure

1.1.1 Tally.ERP 9

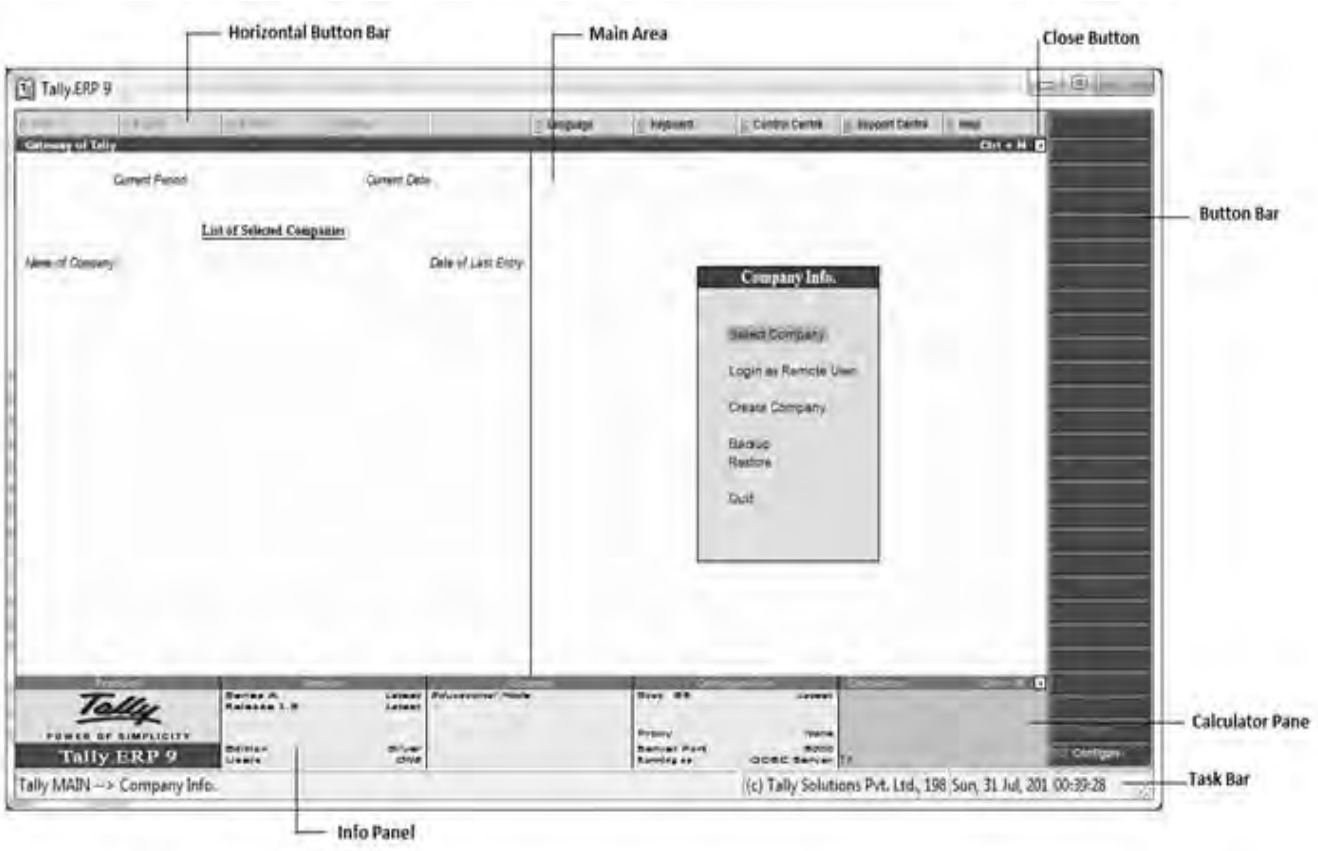
Tally ERP 9 is a simplified solution that runs the complex parts of any business such as accounting, compliance and processes in the background. Tally is simple and can be implemented with minimum resources. Some of its features which make it popular in the industry are, as under:

- Simple accounting management
- Compliance management is inbuilt–GST and pre GST era
- Generates business reports for various purposes
- Flexible inventory management
- Budget and controls

- Sharing and remote access with data synchronization features

It has been observed that currently most of the small and medium level businesses use this ERP application to manage their businesses. In order to investigate the books of accounts and other related issues, it is necessary that the investigators must be familiar with the various features and operations of this application.

Tally–Company Information Screen-Company information is the first screen in tally.



The Main Area is separated into two parts- Left-hand side area and Right-hand side area

The left-hand side provides information of Current Period, Current Date and List of Selected Companies (Name of the company and the date when last entry has been made). The right-hand side displays the Company Information menu such as Select a Company, Create a Company, Backup a Company or Restore a Company and so on.

Left Hand side of the screen consists of the basic information about the company. All the details given here will become the header of all the reports generated through tally. *Right hand side* is divided into two parts *viz.* Company details and Security control. Since tally is an ERP, the software is not restricted only till financial transactions it can even be used to maintain the quantitative data related to inventories. So if the user wants to maintain the quantitative data then he must select Accounts with Inventory otherwise Accounts Only.

Important Things to Note from Security Controls in Tally

There are following two types of passwords in tally:

1. **Tally Vault Password:** Tally Vault is a kind of advanced level security feature built in Tally. It keeps up confidentiality of information by encrypting the data. If the company has used Tally Vault password then in place of the name of the company in (Select Company Option) the user only see asterisk marks.
2. **Login Password:** Login user ID/ Password restricts the unauthorized access to data.

In order to access the tally data, the user must have the required password. However there are few techniques via which the password can be cracked but it needs some technical knowledge.

Disallow opening in Educational Mode is a very important field. If the assessee has turned this option to yes then the tally data of that company cannot be opened using Educational Version of tally, hence the person trying to access the data must have a licensed version of tally.

Precaution

At the time of taking the tally backup the option must be turned to NO.

Company creation is a one page process in tally. The tally data created in Tally ERP 9 is a 5 digit numeric folder (for ex. 10003, 12345) and if it's Tally 7.2 then a 4 digit numeric folder (for ex. 1003, 1234). Tally ERP 9 and Tally 7.2 are the two widely used versions. Other versions are presently not in use.

It is a Frequently Asked Question that: What if the assessee is maintaining records in Tally 7.2, can we open the same in Tally ERP 9?

- In case the company is maintaining accounts in Tally 7.2, then the same can be opened in Tally ERP 9 but only after migration. Migration is a small process to convert the data from a lower version to a higher version using freely available tool called Tally Migration Tool. (Search for Tally Migration tool in Google).

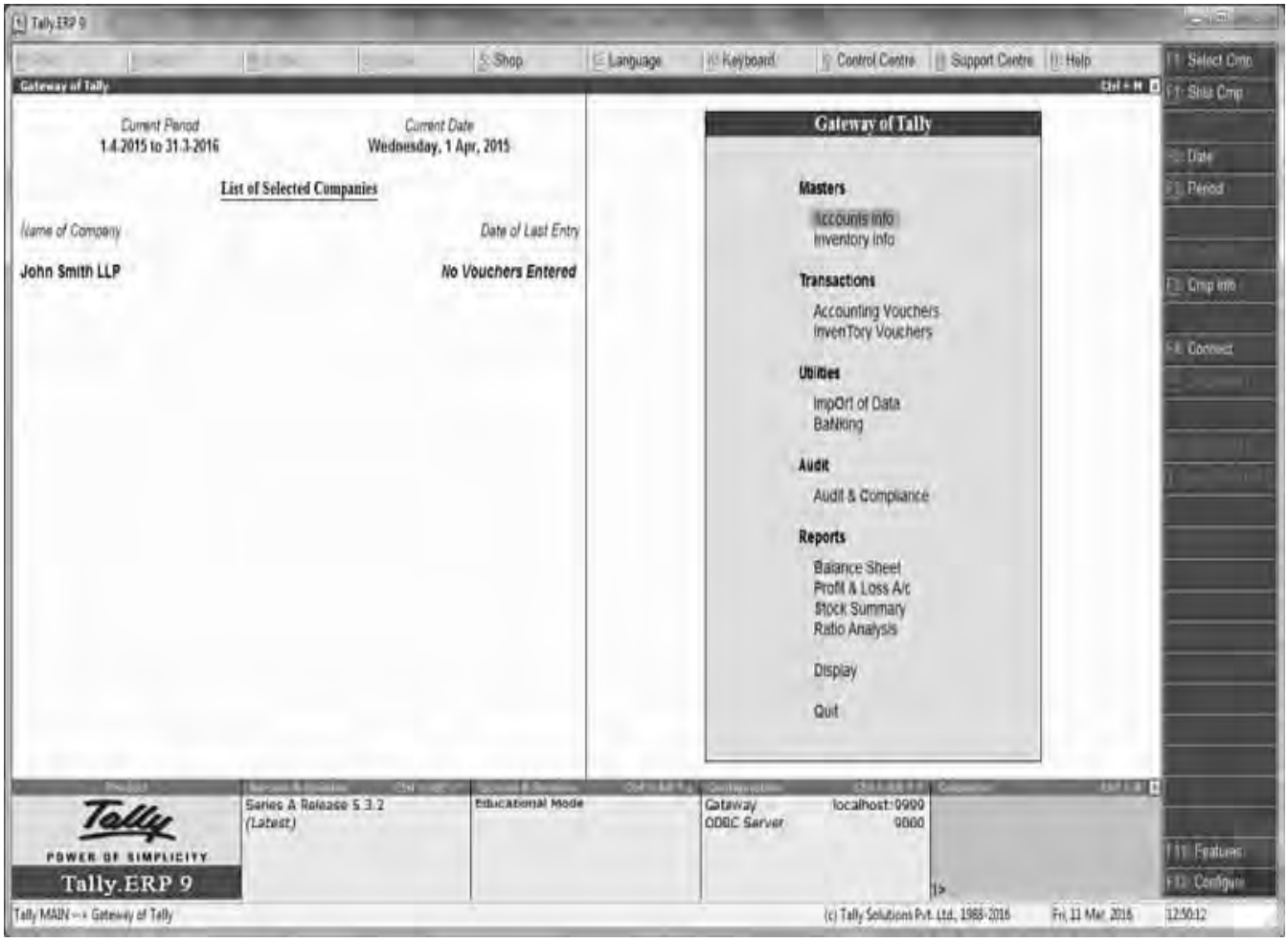
1.1.2 How to Open a Company in Tally

Following are the various ways to open a tally data.

1. The tally data stored in by default path of tally (the path where the tally software has been installed) will open as soon as we open the software.

2. If the tally data is stored in some other folder then there are two ways.
    a. The path of the folder, where the tally data is stored should be copied (Ctrl + C) and pasted (Alt+Ctrl+V) to the path Section under select company option.
    b. Drag and drop the folder containing tally data on the tally software.

1.1.3 Gateway of Tally



Gateway of Tally is the screen that appears on selecting a company. The Gateway of Tally menu differs based on the type of company selected. An Accounts Only Company has a different Gateway of Tally menu from that of an Accounts-with-Inventory Company. Accounts-with-Inventory Company will consist of some additional items like Inventory Info and Stock Summary.

1.2 Main Area

The left side of the Main Area gives information on:

1.2.1 Current Period

It is the currently loaded company's accounting period. (We must set it to the period for which we need to do the audit).

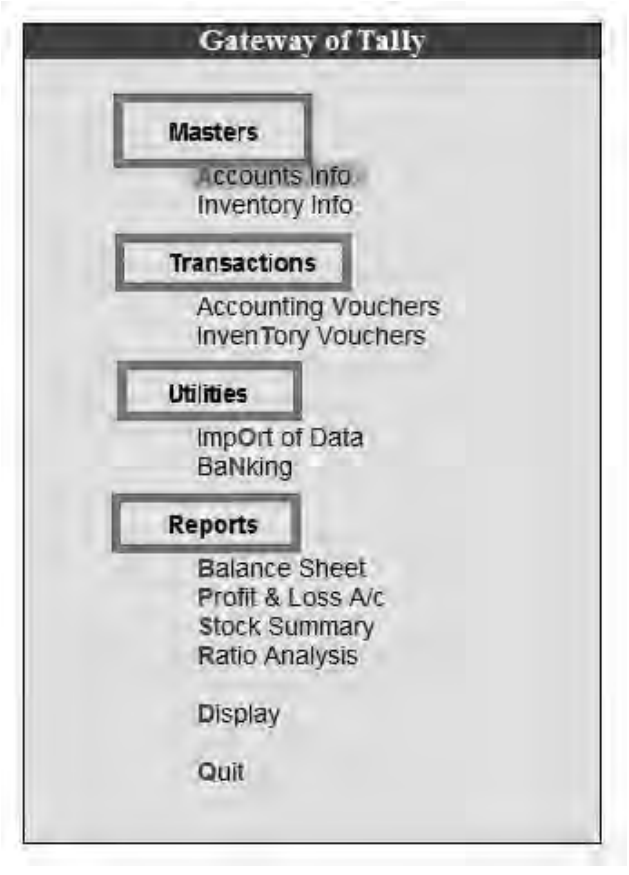
1.2.2 Current Date

This is the date of the last Voucher Entry for the selected company.

1.3 List of Selected Companies

This displays the name of the loaded company. (It can be even more than one)

Gateway of Tally is divided into four different components. Each component has its own function and contains several options for the user.



Masters in Gateway of Tally

Primarily, there are two options in Masters in Gateway of Tally. They are:

a. Accounts Info.

b. Inventory Info.

a. Accounts Info.

It includes everything about ledgers and groups. If you want to create or alter a new ledger, you have to go through Accounts Info. In order to pass any transactions in tally the first step is to create a ledger and the same can be done only through Accounts Info- Create Ledger.

b. Inventory Info.

As the name suggests, it includes everything about stocks or in accounting terms, the inventory. Similar to Accounting Info., you can create and alter Stock Items and Stock Groups. This is where you can create stock items and group them on the basis of Stock Groups for further classification of your goods.

For example, you have Mobiles and Computers at your shop. You can create a group called Mobiles and put the Stock Item in that group known as Apple Iphone X and Samsung Galaxy S8. In the same way, you can create another Stock Group called Computers and put in the Stock Items like Samsung Laptop and HP Laptop.

1.4 Transactions in Gateway of Tally

Transactions part is one the most used components on the Gateway of Tally screen. It is used for creating accounting entries as well as inventory entries in Tally. Similar to Masters, Transactions in Gateway of Tally also contains two options. They are:

a. Accounting Vouchers

b. Inventory Vouchers

a. Accounting Vouchers

There are six basic accounting vouchers in Tally. They are Contra, Payment, Receipt, Journal, Sales and Purchases. Whenever you need to create or pass an accounting entry, you have to go to the Accounting Vouchers in Tally. It is under Transactions because whenever you create an accounting voucher, it is a kind of a transaction.

b. Inventory Vouchers

Inventory Vouchers are mainly used for entries pertaining to manufacturing or assembling businesses. When you have a number of components and you manufacture a finished product–inventory vouchers are used for recording that entry in Tally. For example, you manufacture a pen from ink, nib and a body. This kind of entry can be recorded in Tally with the help of Inventory Vouchers.

1.5 Inbuilt Controls in Accounting Vouchers

1.5.1 Common Points for All the Type of Vouchers

a. The debit and the credit side of the voucher must tally if there is any difference then tally will not accept the voucher.

b. The transaction date must relate to same financial year.

c. There cannot be two ledgers with exactly same name.

d. There is no restriction by default for back dated entries and the voucher numbers get automatically adjusted in case of back dated entry is passed.

a. Introduction to Contra Voucher

As per the Accounting Principles, a Contra entry is a transaction involving transfer of cash between one Cash A/c to another or one Cash A/c to another Bank A/c i.e., is a transaction indicating transfer of funds from:

- Cash account to Cash account
- Cash account to Bank account
- Bank account to Cash account
- Bank account to Bank account

By Default Setting

No voucher can be passed unless the bank/ cash account is debited as well as credited in this voucher. However the user can change the configuration setting using F12–Configuration to surpass this control.

b. Introduction to Payment Voucher

Payment voucher is used to account all the payments made by the company by way of Cash/ Bank. Payment voucher can be passed using Single Entry or Double Entry mode by configuring the setting Use Single Entry mode for Payment/ Receipt/ Contra in F12 configuration. *All payment entries (whether capital/ revenue) are passed only by using payment voucher.*

By Default Setting

No voucher can be passed unless the bank/ cash account is credited in this voucher and this voucher doesn't allow bank/ cash as a debit item. However the user can change the configuration setting using F12–Configuration to surpass this control.

c. Introduction to Receipt Entry

Any money received from debtors against Sales Invoices or on Account and for all transactions where money is received are accounted or entered using the Receipt Voucher. *All receipt entries (whether capital/ revenue) are passed only by using receipt voucher.*

By Default Setting

No voucher can be passed unless the bank/ cash account is debited in this voucher and this voucher doesn't allow bank/ cash as a credit item. However the user can change the configuration setting using F12–Configuration to surpass this control.

d. Introduction to Purchase Voucher

Purchase voucher is used to record the Purchase transactions of the company. The entry can be passed using the Voucher mode or the Invoice mode, where the calculations can be automated and the user can experience the ease of feeding the

transactions into the system. *Though there is a specific voucher to record purchase transactions but all purchase entries may not be passed only by using purchase voucher.* For recording cash purchases the accountant can use purchase voucher as well as payment voucher and for recording credit purchases the user may use purchase as well as journal voucher. *Important thing to note here is that the entries passed using purchase voucher will only reflect in purchase register. This is one of the reasons for the difference in total purchases as per profit & loss account and purchase register.* The purchase figure reflected in the Profit and loss account gives the gross figure and hence is the correct figure.

e. Introduction Sales Voucher

Sales Voucher is used to record the Sales transactions of the company. You can pass an entry using the Voucher mode or the Invoice mode where the calculations can be automated and the transactions can be fed into the system easily. *Though there is a specific voucher to record sales transactions but all sales entries may not be passed only by using sales voucher.* For recording cash sales the accountant can use sales voucher as well as receipt voucher and for recording credit sales the user may use sales as well as journal voucher. *Important thing to note here is that the entries passed using sales voucher will only reflect in sales register. This is one of the reasons for the difference in total sales as per profit & loss account and sales register.* The sales figure reflected in the Profit and loss account gives the gross figure and hence is the correct figure.

f. Recording a Journal Entry

Journal Vouchers are used to adjust the debit and credit amounts without involving the cash or bank accounts. Hence, they are referred to as adjustment entries. Journals are used for all non- cash transactions. *However with the help of Configuration the journal can be used to pass cash transactions as well.*

1.6 Utilities in Gateway of Tally

There are two options again in Utilities in Gateway of Tally and they are–

a. Import Data

b. Banking

a. Import Data

Import data option allows the import of data (Masters as well as Vouchers) in tally from external sources. The data can be imported only in XML format. There are few macros which has been designed to import the information by converting excel into XML. This option is used when the company is in need of transferring data from one tally company to another or if there is a need for any bulk entries.

b. Banking

Banking option allows the user to view all the banking related options at one place. There are options like Cheque Printing, Cheque Register, Bank Reconciliation, Deposit Slip, Payment Advice and Post-dated Summary. *From audit point of view the Bank Reconciliation and Post-dated summary is relevant.*

1.7 Reports Generated through Tally

A Report is an organized and formatted presentation of Data in the form of text graphics and calculation. Tally allow user to collect different type of data such as voucher and invoices and display them in the form of reports. There are various categories of reports in tally such as Balance Sheet, profit and loss account, stock summary and ratio analysis. The user interface of tally allows to view all these reports.

1.7.1 Balance Sheet

Balance Sheet is a financial reporting tool that allows you to perform a quantitative analysis of company's asset, liabilities and net worth at a particular date, such as at the end of financial year. In other words, it reflects the quantitative and summarized form of financial position of a company in a particular period. Balance Sheet displays the owner's funds of a company and its net worth in business. This information helps to analyze the capacity of business to take risk as well as future planning.

How to Configure Balance Sheet in Tally

Go to gateway of tally > under reports go to Balance Sheet. Click F 12 Configure screen to set the configuration for displaying the Balance Sheet according to your requirement. The configuration screen of Balance Sheet has number of option and setting these options is important so that the Balance-Sheet is generated in the desired format. It is therefore important to understand the meaning and purpose of those options. The following are the options displayed in the configuration screen:

a. **Show Vertical Balance Sheet:** Generate your Balance Sheet in the vertical format if you set this option then no Balance Sheet will appear in the horizontal format.

b. **Show Percentage:** Display Balance Sheet with percentage column

c. **Show Working Capital Figures:** Allow you to show the value of working Capital, which is the value obtained by subtracting current Assets and Current Liabilities

Detailed/ Condensed View: Tally allows you to view the Balance Sheet in a detailed and the condensed view and the same can be set with the Detail/ Condense option under Alt + F1

Changing the Period: Tally allows you to view the Balance Sheet for any period and the same can be set with the Period option under F2

Comparing Balance Sheet: Tally allows you to compare and know the balance of your account between any two given dates. Perform the following steps to find out your balance between any two dates. Auto Column Option (Alt + N) for standard options and New Column (Alt + C) for customized options.

Schedule III Format: In order to view the Balance Sheet in standard Schedule III format of Companies Act, then tally allows you the option under Alt + S

1.7.2 Profit & Loss

The Profit and loss Account report displays the net profit and loss of company along with the opening and closing stock. To view the profit and loss account report click the profit and loss a/c option under report in the gateway of tally.

Configure Profit and Loss A/c

It is configured by clicking the F12 configure button.

a. **Show Vertical Profit & Loss:** Display information of profit and loss in a Balance Sheet form vertically or horizontally. However you can change by choosing the YES options.

b. **Show Percentage:** Display each line as percentage of sale account.

c. **Show with Gross Profit:** This split profit and loss a/c into two Sections. The Trading Account and the Profit & Loss account.

Detailed/ Condensed View: Tally allows you to view the Profit & Loss in a detailed and the condensed view and the same can be set with the Detail/ Condense option under Alt + F1

Changing the Period: Tally allows you to view the Balance Sheet for any period and the same can be set with the Period option under F2

Comparing Profit & Loss: Tally allows you to compare and know the profit & loss account between any two given dates. Perform the following steps to find out your P&L between any two dates. Auto Column Option (Alt + N)

for standard options and New Column (Alt + C) for customized options.

Schedule III Format: In order to view the Profit & Loss in standard Schedule III format of Companies Act then tally allows you the option under Alt + S

1.7.3 Stock Summary

The Stock summary report displays the statement of stocks which are in hand on a particular date. Whenever any transaction takes place, the stock summary is automatically updated. The stock summary report also gives the current stock position.

To view the sock summary report select

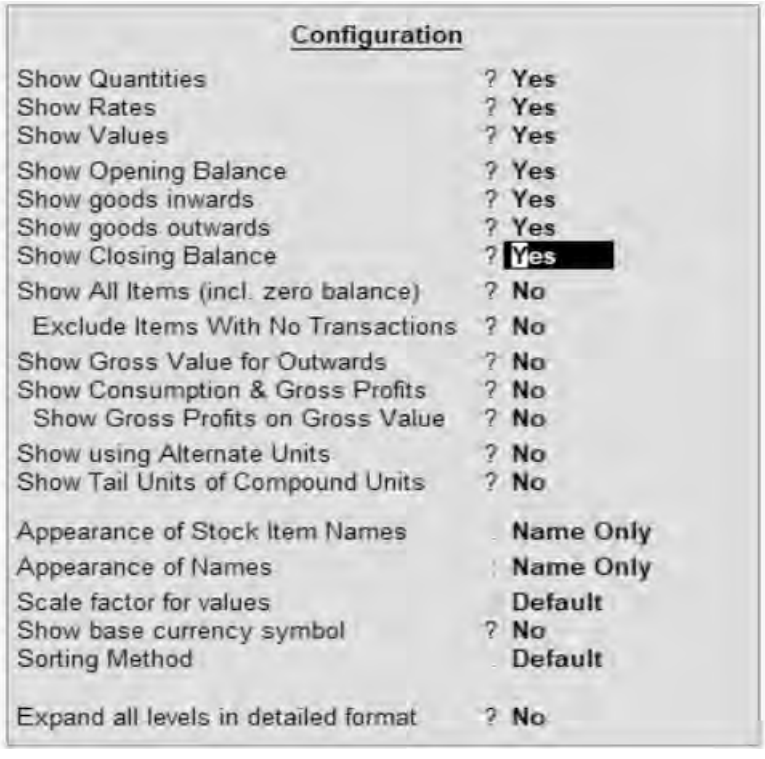
Go to gateway of Tally > Under Report Stock Summary > press f12 >

a. Selecting Stock Valuation for Stock Summary

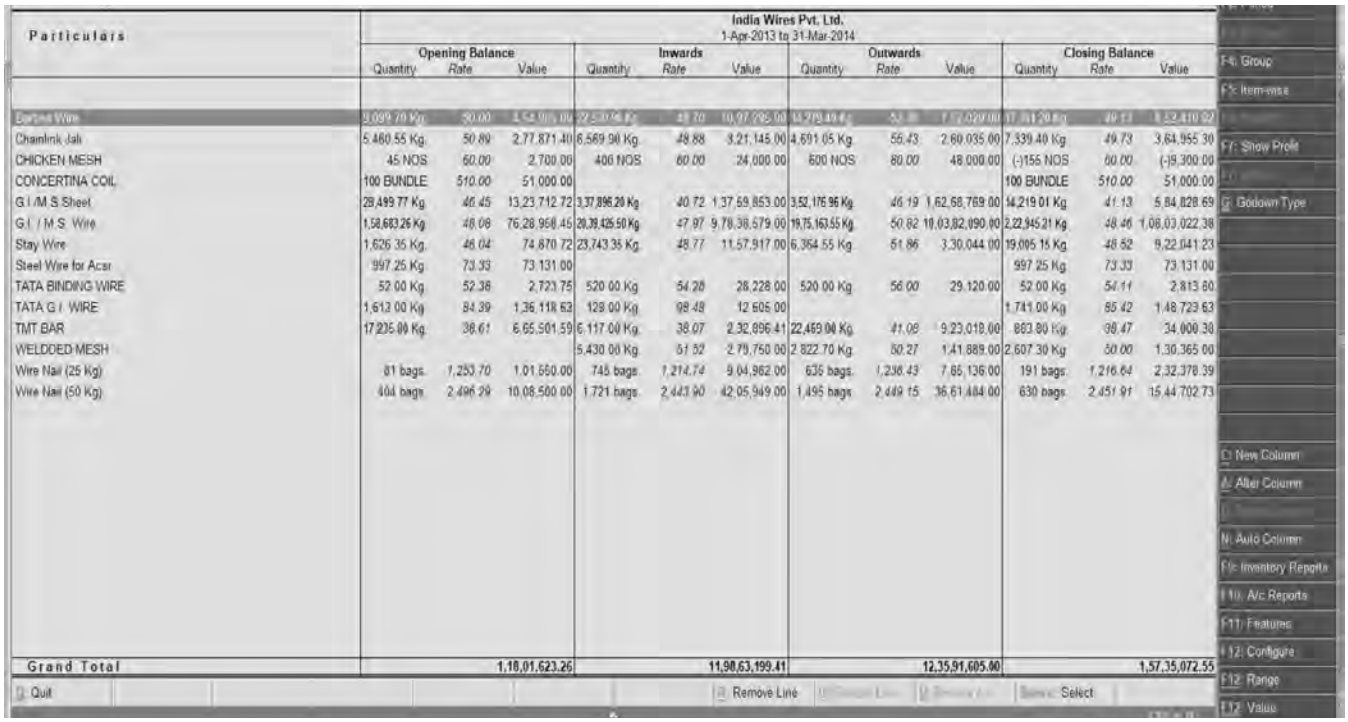
Click on Method of Stock valuation option in the column details. The all valuation methods menu appears. Select stock valuation method from these options according to your requirement. Press esc key or click the close button of the stock summary screen to go back to the gateway of Tally.

b. Opening Stock Summary

In order to view the opening stock summary screen you need to enable the integrate accounts and inventory option by selecting inventory features option from the company features menu. You can access inventory features by clicking the F11 features button in the button bar. Click the profit and loss account option under report in the gateway of Tally menu. The profit and loss a/c screen appears. The report displays the opening stock and closing stock. Double click the opening stock or closing stock in the profit and loss a/c screen to see the item wise details.



DETAILED STOCK SUMMARY



India Wires Pvt. Ltd.
1-Apr-2013 to 31-Mar-2014

Particulars	Opening Balance			Inwards			Outwards			Closing Balance		
	Quantity	Rate	Value	Quantity	Rate	Value	Quantity	Rate	Value	Quantity	Rate	Value
Barbed Wire	9,099.70 Kg	50.00	4,54,985.00	22,500.00 Kg	48.70	10,97,295.00	13,279.49 Kg	52.30	7,17,029.00	18,320.21 Kg	49.13	9,00,410.97
Chainlink Jali	5,460.55 Kg	50.89	2,77,871.40	6,569.90 Kg	48.88	3,21,145.00	4,691.05 Kg	56.43	2,60,035.00	7,339.40 Kg	49.73	3,64,955.30
CHICKEN MESH	45 NOS	60.00	2,700.00	400 NOS	60.00	24,000.00	600 NOS	80.00	48,000.00	(-)155 NOS	60.00	(-)9,300.00
CONCERTINA COIL	100 BUNDLE	510.00	51,000.00							100 BUNDLE	510.00	51,000.00
G.I./M.S.Sheet	28,499.77 Kg	46.45	13,23,712.72	3,37,896.20 Kg	40.72	1,37,59,853.00	3,52,176.96 Kg	46.19	1,62,68,769.00	14,219.01 Kg	41.13	5,84,828.69
G.I. / M.S. Wire	1,58,683.26 Kg	48.08	76,28,958.45	20,39,425.50 Kg	47.97	9,78,38,579.00	19,75,163.55 Kg	50.82	10,03,82,090.00	2,22,945.21 Kg	48.46	1,08,03,022.38
Stay Wire	1,626.35 Kg	46.04	74,870.72	23,743.35 Kg	48.77	11,57,917.00	6,354.55 Kg	51.86	3,30,044.00	19,005.15 Kg	48.52	9,22,041.23
Steel Wire for Acsr	997.25 Kg	73.33	73,131.00							997.25 Kg	73.33	73,131.00
TATA BINDING WIRE	52.00 Kg	52.38	2,723.75	520.00 Kg	54.28	28,228.00	520.00 Kg	56.00	29,120.00	52.00 Kg	54.11	2,813.80
TATA G.I. WIRE	1,613.00 Kg	84.39	1,36,118.63	128.00 Kg	98.48	12,605.00				1,741.00 Kg	85.42	1,48,723.63
TMT BAR	17,235.00 Kg	38.61	6,65,501.59	6,117.00 Kg	38.07	2,32,896.41	22,469.00 Kg	41.06	9,23,018.00	883.80 Kg	38.47	34,000.30
WELDDED MESH				5,430.00 Kg	51.52	2,79,750.00	2,822.70 Kg	50.27	1,41,889.00	2,607.30 Kg	50.00	1,30,365.00
Wire Nail (25 Kg)	81 bags	1,253.70	1,01,550.00	745 bags	1,214.74	9,04,962.00	636 bags	1,236.43	7,86,136.00	191 bags	1,216.64	2,32,378.39
Wire Nail (50 Kg)	404 bags	2,496.29	10,08,500.00	1,721 bags	2,443.90	42,05,949.00	1,495 bags	2,449.15	36,61,484.00	630 bags	2,451.91	15,44,702.73
Grand Total			1,18,01,623.26			11,98,63,199.41			12,35,91,605.60			1,57,35,072.55

Quit | Remove Line | Select

F4: Group | F5: Item-wise | F7: Show Profit | F9: Godown Type | D: New Column | A: Alter Column | N: Auto Column | F6: Inventory Reports | F10: A/c Reports | F11: Features | F12: Configure | F12: Range | F12: Value

1.7.4 Ratio Analysis

The ratio report is a single sheet performance report for a specific period. This report is used by the top management to analyze the financial health of a company and where it is going to stand after a certain period of time. This report is useful because it allows an individual to instantly assess a company or industry by making two basic comparisons. The top management compare the company's present with the past ratio to determine, as to whether there has been any improvement in the efficiency of the business or not. From audit point of view we can quickly get the important ratio for comparison to identify major deviation. It helps inter and intra firm comparisons.

Note: In order to rely on the ratio analysis report generated through tally one must ensure correct grouping of accounts.

1.7.5 Trial Balance

A Trial Balance is a summary of all ledger balances to check whether the figures are correct and balanced. Considering that the journal entries are error-free and posted correctly to the general ledger, the total of all debit balances should equal the total of all the credit balances. In Tally.ERP 9, the matching of the Trial Balance is a foregone conclusion since all voucher entries are in Debit - Credit format and must balance at the entry point.

To view the Trial Balance, Go to Gateway of Tally > Display >Trial Balance

Tally.ERP 9 shows group wise Trial Balance. Details of all groups can also be obtained through configuration, except for groups behaving like sub-ledgers.

Follow the following steps to view the trail balance in detailed format.

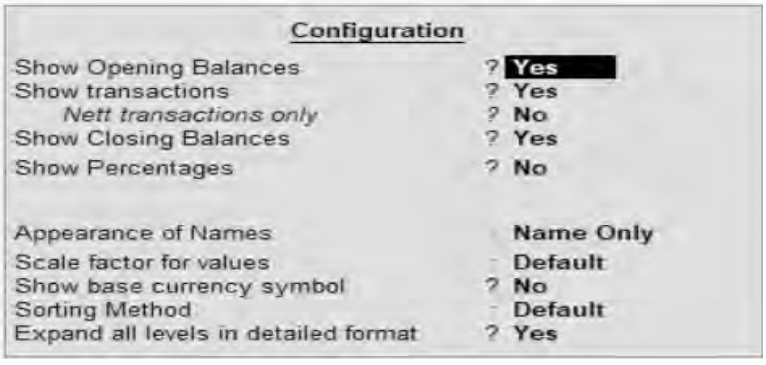
1. Press Alt+ F1 (to have detailed view)
2. Press F12 (for configuration) select
   a. Show Opening balance: Yes
   b. Show Closing balance: Yes
   c. Show Transactions: Yes

d. Show Net Transactions: No

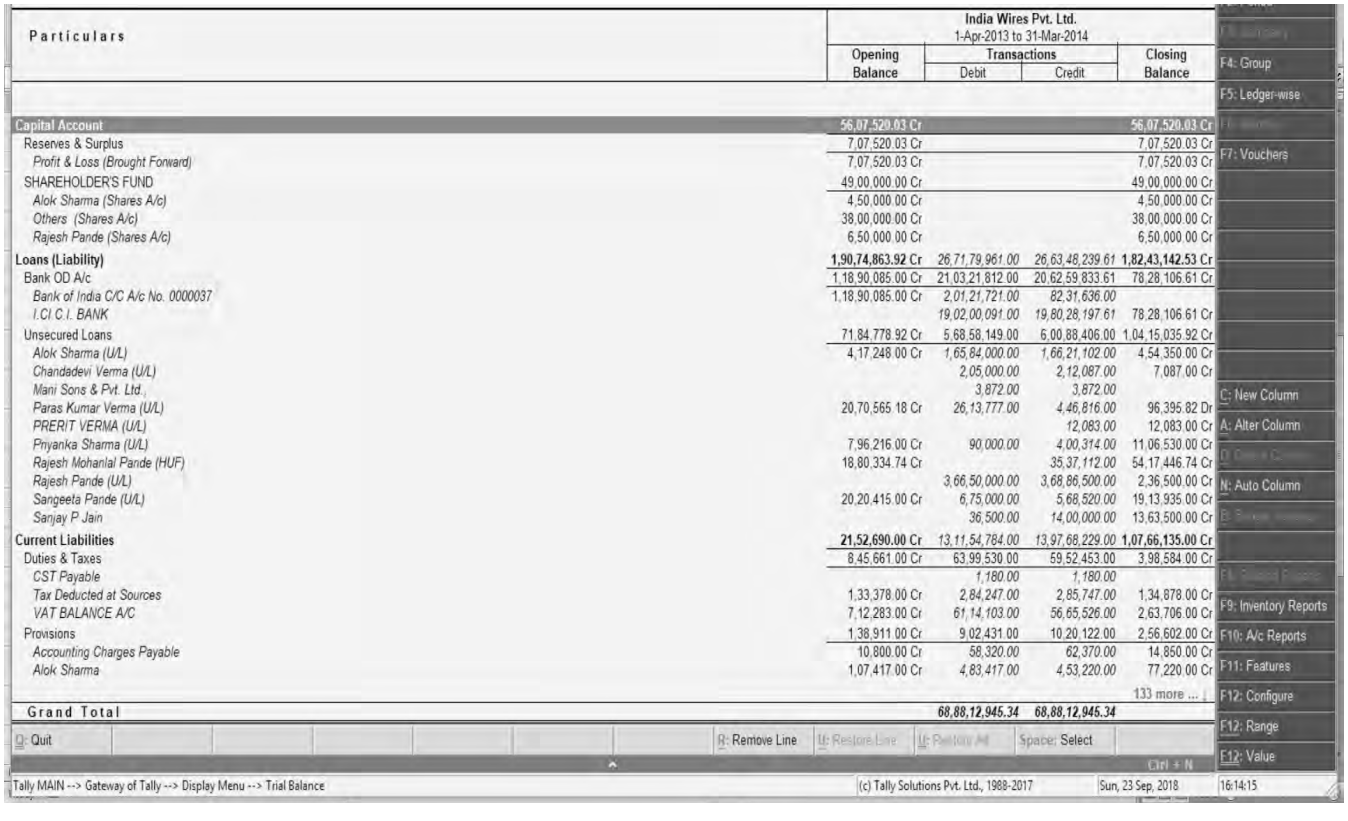
e. Expand All levels: Yes

3. Expand Sundry Creditors and Sundry Debtors (Press Shift+ Enter)

CONFIGURATION



DETAILED TRIAL BALANCE



India Wires Pvt. Ltd.
1-Apr-2013 to 31-Mar-2014

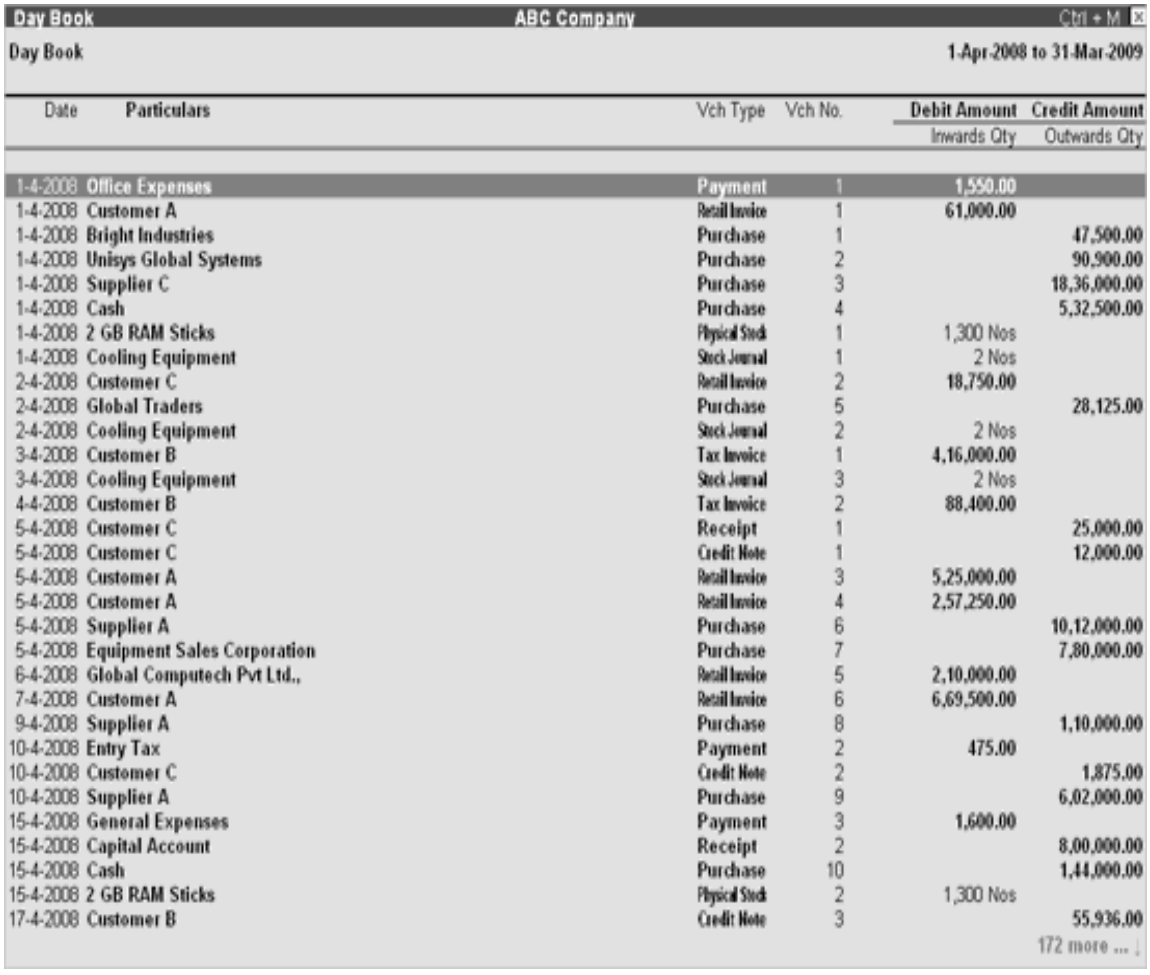
Particulars	Opening Balance	Transactions Debit	Transactions Credit	Closing Balance
Capital Account	56,07,520.03 Cr			56,07,520.03 Cr
Reserves & Surplus	7,07,520.03 Cr			7,07,520.03 Cr
Profit & Loss (Brought Forward)	7,07,520.03 Cr			7,07,520.03 Cr
SHAREHOLDER'S FUND	49,00,000.00 Cr			49,00,000.00 Cr
Alok Sharma (Shares A/c)	4,50,000.00 Cr			4,50,000.00 Cr
Others (Shares A/c)	38,00,000.00 Cr			38,00,000.00 Cr
Rajesh Pande (Shares A/c)	6,50,000.00 Cr			6,50,000.00 Cr
Loans (Liability)	1,90,74,863.92 Cr	26,71,79,961.00	26,63,48,239.61	1,82,43,142.53 Cr
Bank OD A/c	1,18,90,085.00 Cr	21,03,21,812.00	20,62,59,833.61	78,28,106.61 Cr
Bank of India C/C A/c No. 0000037	1,18,90,085.00 Cr	2,01,21,721.00	82,31,636.00	
I.C.I.C.I. BANK		19,02,00,091.00	19,80,28,197.61	78,28,106.61 Cr
Unsecured Loans	71,84,778.92 Cr	5,68,58,149.00	6,00,88,406.00	1,04,15,035.92 Cr
Alok Sharma (U/L)	4,17,248.00 Cr	1,65,84,000.00	1,66,21,102.00	4,54,350.00 Cr
Chandadevi Verma (U/L)		2,05,000.00	2,12,087.00	7,087.00 Cr
Mani Sons & Pvt. Ltd.,		3,872.00	3,872.00	
Paras Kumar Verma (U/L)	20,70,565.18 Cr	26,13,777.00	4,46,816.00	96,395.82 Dr
PRERIT VERMA (U/L)			12,083.00	12,083.00 Cr
Priyanka Sharma (U/L)	7,96,216.00 Cr	90,000.00	4,00,314.00	11,06,530.00 Cr
Rajesh Mohanlal Pande (HUF)	18,80,334.74 Cr		35,37,112.00	54,17,446.74 Cr
Rajesh Pande (U/L)		3,66,50,000.00	3,68,86,500.00	2,36,500.00 Cr
Sangeeta Pande (U/L)	20,20,415.00 Cr	6,75,000.00	5,68,520.00	19,13,935.00 Cr
Sanjay P Jain		36,500.00	14,00,000.00	13,63,500.00 Cr
Current Liabilities	21,52,690.00 Cr	13,11,54,784.00	13,97,68,229.00	1,07,66,135.00 Cr
Duties & Taxes	8,45,661.00 Cr	63,99,530.00	59,52,453.00	3,98,584.00 Cr
CST Payable		1,180.00	1,180.00	
Tax Deducted at Sources	1,33,378.00 Cr	2,84,247.00	2,85,747.00	1,34,878.00 Cr
VAT BALANCE A/C	7,12,283.00 Cr	61,14,103.00	56,65,526.00	2,63,706.00 Cr
Provisions	1,38,911.00 Cr	9,02,431.00	10,20,122.00	2,56,602.00 Cr
Accounting Charges Payable	10,800.00 Cr	58,320.00	62,370.00	14,850.00 Cr
Alok Sharma	1,07,417.00 Cr	4,83,417.00	4,53,220.00	77,220.00 Cr
				133 more ...
Grand Total		68,88,12,945.34	68,88,12,945.34	

1.7.6 Day Book

The Day Book lists all transactions made in a particular day and by default displays the last voucher entry date of a regular voucher. It could also be setup to list all the transactions made over a certain period. Transactions include all types of vouchers financial vouchers.

1.7.7 To View the Day Book

1. Go to Gateway of Tally > Display >Day book. The Day Book will appear as shown below:



Day Book — ABC Company — Ctrl + M

Day Book — 1-Apr-2008 to 31-Mar-2009

Date	Particulars	Vch Type	Vch No.	Debit Amount / Inwards Qty	Credit Amount / Outwards Qty
1-4-2008	Office Expenses	Payment	1	1,550.00	
1-4-2008	Customer A	Retail Invoice	1	61,000.00	
1-4-2008	Bright Industries	Purchase	1		47,500.00
1-4-2008	Unisys Global Systems	Purchase	2		90,900.00
1-4-2008	Supplier C	Purchase	3		18,36,000.00
1-4-2008	Cash	Purchase	4		5,32,500.00
1-4-2008	2 GB RAM Sticks	Physical Stock	1	1,300 Nos	
1-4-2008	Cooling Equipment	Stock Journal	1	2 Nos	
2-4-2008	Customer C	Retail Invoice	2	18,750.00	
2-4-2008	Global Traders	Purchase	5		28,125.00
2-4-2008	Cooling Equipment	Stock Journal	2	2 Nos	
3-4-2008	Customer B	Tax Invoice	1	4,16,000.00	
3-4-2008	Cooling Equipment	Stock Journal	3	2 Nos	
4-4-2008	Customer B	Tax Invoice	2	88,400.00	
5-4-2008	Customer C	Receipt	1		25,000.00
5-4-2008	Customer C	Credit Note	1		12,000.00
5-4-2008	Customer A	Retail Invoice	3	5,25,000.00	
5-4-2008	Customer A	Retail Invoice	4	2,57,250.00	
5-4-2008	Supplier A	Purchase	6		10,12,000.00
5-4-2008	Equipment Sales Corporation	Purchase	7		7,80,000.00
6-4-2008	Global Computech Pvt Ltd.,	Retail Invoice	5	2,10,000.00	
7-4-2008	Customer A	Retail Invoice	6	6,69,500.00	
9-4-2008	Supplier A	Purchase	8		1,10,000.00
10-4-2008	Entry Tax	Payment	2	475.00	
10-4-2008	Customer C	Credit Note	2		1,875.00
10-4-2008	Supplier A	Purchase	9		6,02,000.00
15-4-2008	General Expenses	Payment	3	1,600.00	
15-4-2008	Capital Account	Receipt	2		8,00,000.00
15-4-2008	Cash	Purchase	10		1,44,000.00
15-4-2008	2 GB RAM Sticks	Physical Stock	2	1,300 Nos	
17-4-2008	Customer B	Credit Note	3		55,936.00

172 more ... ↓

2. Click F2: Period to change the period for which the Day Book is displayed.
3. Click F4: Change Vouch to view Day Book for a particular voucher type.

1.8 Account Books

Books of account record the individual transaction details you have entered. Although you may post items to many different ledgers, Tally brings all the transactions of one category together into a book of account for viewing and printing. All books are displayed first as a monthly summary with opening and closing balances.

Select a month and press [enter] to display all transactions for the month. Then press F2 to change the period for which the transactions are to be viewed.

Following are the different types of account books depending upon the category of transactions:

1. **Cash Book:** Will show all the transactions affecting cash.
2. **Bank Book:** Will show all the transactions affecting bank
3. **Ledger:** Will show all the transactions entered with any specific ledger account.

4. **Group Summary:** The group summary statement shows the closing balances of the accounts of a selected group for a specified period up to the current date. The default view is that of sub-groups within a group. To view group summary: Go to Gateway of Tally > Display > Account Books > Group Summary> Select a group.

5. **Group Vouchers:** It is a list of all vouchers having at least one ledger account entry belonging to the selected group. This statement is useful when you want to list all transactions for a particular group.

   To View the Group Vouchers: Go to Gateway of Tally- Display-Account Books-Group Vouchers.

6. **Sales/ Purchase Register:** Sales/ Purchase Register displays the monthly summary of Sales/ Purchase transactions and closing balances. The list of transactions pertaining to each month can be viewed by selecting that month and viewing its details. The period of the report can be modified by F2.Tally.ERP 9 permits you to change the display according to the information required. Columnar periodic reports can be generated using Alt+N: Auto Column button for different periods as shown by the columnar details list. To view Sales/ Purchase Register, Go to Gateway of Tally-Display-Account books -Sales/ Purchase Register.

Note: *Sales/ Purchase Register will show only those entries which have been passed using sales/ purchase vouchers. The entries passed using journal, receipt & payment vouchers will not be reflected here. Further Sales/ Purchase Register shows gross figure (inclusive of indirect taxes) whereas the profit and loss will show net figure. Hence there will always be a difference between the figures reflected in profit & loss account and registers.*

7. **Journal Register:** Journal register report displays all the journal vouchers that have been passed. To view journal register details Go to Gateway of Tally > Display > Account Books > Journal Register.

8. **Statistics:** The Statistics report displays the Masters created and the number of vouchers types entered. You can drill down to the transaction level from this report. To view the Statistics report Go to Gateway of Tally > Display > Statement of Accounts > Statistics

1.9 Tally Shortcuts

Tally is a software which must be operated through key board shortcuts. The short cuts are created using function keys given on the top of the key board. On every screen the right hand panel and the top screen have some shortcuts that is relevant for the active screen. Following is a small logic behind those shortcuts.

a. If the function key is with a single line (Ex: F1) Then use ALT+ Function key

b. If the function key is with a double line (Ex: F2) Then use CTRL+ Function key and

c. If the function key is with a no line (Ex: F1) Then simply use that Function key

Around 80% of the work can be done with the above mentioned logic. Besides that there are few more shortcuts which are created using some special key combinations. Following is the list of the Special Key Combination.

Windows	Functionality	Availability
ALT + 2	To Duplicate a voucher	At List of Vouchers–creates a voucher similar to the one where you positioned the cursor and used this key combination
ALT + A	To Add a voucher	At List of Vouchers–adds a voucher after the one where you positioned the cursor and used this key combination.
	To Alter the column in columnar report	Alters the column in all the reports which can be viewed in columnar format
ALT + C	To create a master at a voucher screen (if it has not been already assigned a different function, as in reports like Balance Sheet, where it adds a new column to the report)	At voucher entry and alteration screens, at a field where you have to select a master from a list. If the necessary account has not been created already, use this key combination to create the master without quitting from the voucher screen.
	To access Auto Value Calculator in the amount field during voucher entry	At all voucher entry screens in the Amount field
ALT + D	To delete a voucher/ master	At Voucher and Master (Single) alteration screens. Masters can be deleted subject to conditions, as explained in the manual.
		All the reports screen which can be viewed in columnar format
ALT + E	To export the report in ASCII, Excel, HTML OR XML format	At all reports screens in TALLY.ERP 9
ALT + I	To insert a voucher	At List of Vouchers–inserts a voucher before the one where you positioned the cursor and used this key combination.
	To toggle between Item and Accounting invoice	At creation of sales and purchase invoice
ALT + G	To select the Language Configuration	At almost all screens in TALLY.ERP 9
ALT + K	To select the Keyboard Configuration	At almost all screens in TALLY.ERP 9
ALT + O	To upload the report at your website	At all reports screens in TALLY.ERP 9
ALT + G	To select language for TALLY.ERP 9 Interface	At almost all screens of TALLY.ERP 9
ALT + M	To Email the report	At all reports screens in TALLY.ERP 9
ALT + N	To view the report in automatic columns	At all the reports where columns can be added
ALT + P	To print the report	At all reports screens in TALLY.ERP 9
ALT + R	To repeat the narration in different voucher type	At all Vouchers in TALLY.ERP 9
ALT + S	To bring back a line you removed using ALT + R	At all reports screens in TALLY.ERP 9
ALT + U	To retrieve the last line which is deleted using Alt + R	At all reports screens in TALLY.ERP 9
ALT+ V	From Invoice screen to bring Stock Journal screen	At Invoice screen > Quantity Field > Press Alt + V to select the Stock Journal.

Windows	Functionality	Availability
ALT + X	To cancel a voucher in Day Book/ List of Vouchers	At all voucher screens in TALLY.ERP 9
ALT + R	To repeat the narration in different voucher type	At almost all screens in TALLY.ERP 9.
CTRL + A	To accept a form–wherever you use this key combination, that screen or report gets accepted as it is	At almost all screens in TALLY.ERP 9, except where a specific detail has to be given before accepting
CTRL + B	To select the Budget	At Groups/ Ledgers/ Cost Centres/ Budgets/ Scenarios/ Voucher Types/ Currencies (Accounts Info) creation and alteration screen
CTRL + ALT + B	To check the Company Statutory details	At all the menu screens
CTRL + C	To select the Cost Centre	At Groups/ Ledgers/ Cost Centres/ Budgets/ Scenarios/ Voucher Types/ Currencies (Accounts Info) creation and alteration screen
	To select the Cost Category	At Stock Groups/ Stock Categories/ Stock Items/ Reorder Levels/ Godowns/ Voucher Types/ Units of Measure (Inventory Info) creation/ alteration screen
CTRL+ E	To select the Currencies	At Groups/ Ledgers/ Cost Centres/ Budgets/ Scenarios/ Voucher Types/ Currencies (Accounts Info) creation and alteration screen
CTRL + G	To select the Group	At Groups/ Ledgers/ Cost Centres/ Budgets/ Scenarios/ Voucher Types/ Currencies (Accounts Info) creation and alteration screen
CTRL + H	To view the Support Centre	At Almost all screens in TALLY.ERP 9
CTRL + I	To select the Stock Items	At Stock Group/ Stock Categories/ Stock Items/ Reorder Levels/ Godowns/ Voucher Types/ Units of Measure (Inventory Info) creation/ alteration screen

2. INVESTIGATION OF ACCOUNTS IN SAP-SYSTEMS APPLICATIONS AND PRODUCTS IN DATA PROCESSING

(German: Systeme, Anwendungen, Produkte in der Datenverarbeitung)

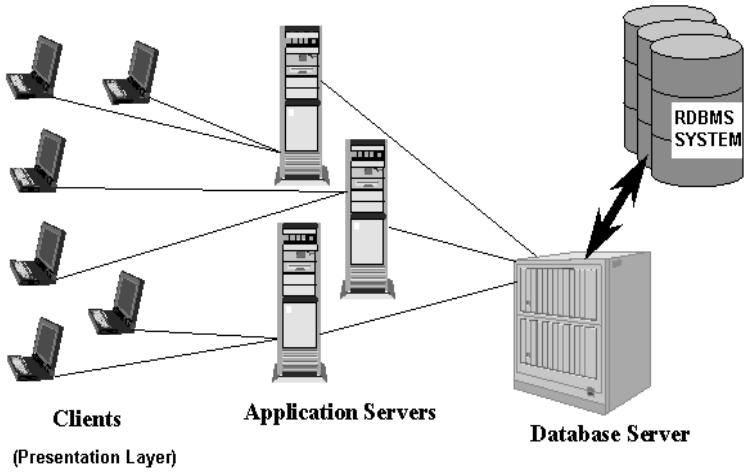
SAP, started in 1972 by five former IBM employees in Mannheim, Germany, it is claimed to be the world's third-largest independent software vendor. The full form of SAP is "Systems Applications and Products in Data Processing." The goal of the company was to provide large enterprise customers with the ability to interact with a corporate database in real-time. Today, the company states that its goal is "to offer the industry's most comprehensive portfolio of business performance and optimization solutions for companies of all sizes."

SAP's first software application was a financial accounting software suite that ran on a mainframe and was known for its stability. It eventually became known as the R/ 1 system. The "R" stands for real-time. During the 1980s, the company went international, and the second iteration of the R system (R/ 2) accommodated different languages and currencies. In the 1990s, the third iteration (R/ 3) moved from the mainframe to a client/ server three-tier architecture composed of a database, software applications and a

common graphical user interface (GUI). SAP used the name R/ 3 until the 5.0 release. At that time the name was changed from R/version to ERP Central Component (ECC) version starting from 6.0 to 7.0.

2.1 SAP R/ 3 Architecture

- The SAP R/ 3 architecture is based on a 3-tier client/ server principle
  - Presentation Server
  - Application Server
  - Database Server
- Dedicated Servers are linked by Communication Networks
- Perform tasks without sacrificing data integration and processes within the system, as a whole



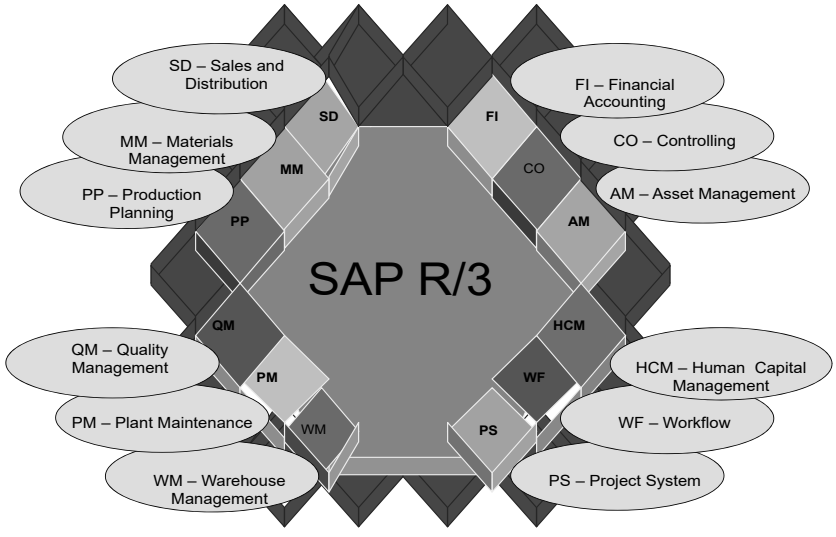
During investigation, in the worst case scenario, if we need to take the entire copy of the data, only copying the data would not be sufficient to read the data with the application. Therefore, it is required to take the database copy along with the application and proper access to the system.

Database server contains the entire data of the enterprise, however Application Server contains the application environment to read and access the data.

2.1.1 Overview of Presentation Server and Database Server

- **The Presentation Server**
  - GUI only
  - At workstation
  - Very light
  - Sends requests to application server
  - Obtains screens from application server and displays
- **The Database Server**
  - Interface between application server and RDBMS
  - Also holds the vendor specific DB driver

2.2 SAP R/ 3 Modules



The various modules in R/ 3 are given below:

- **Financial Accounting**

  Financial Accounting is designed for automated management and external reporting of general ledger, accounts receivable, accounts payable and other sub-ledger accounts with a user defined chart of accounts. As entries are made relating to sales production and payments journal entries are automatically posted. This connection means that the "books" are designed to reflect the real situation.

- **Controlling**

  Controlling represents the company's flow of cost and revenue. It is a management instrument for organisational decisions. It is also automatically updated as events occur.

- **Assets Management**

  Asset Management is designed to manage and supervise individual aspects of fixed assets including purchase and sale of assets, depreciation and investment management.

- **Sales and Distribution**

  Sales and Distribution helps to optimize all the tasks and activities carried out in sales, delivery and billing. The key elements are; pre-sales support, inquiry processing, quotation processing, sales order processing, delivery processing, billing and sales information system.

- **Materials Management**

  Materials Management supports the procurement and inventory functions occurring in day-to-day business operations such as purchasing, inventory management, reorder point processing, etc.

- **Production Planning**

  Production Planning is used to plan and control the manufacturing activities of a company. This module includes; bills of material, routings, work Centres, sales and operations planning, master production scheduling, material requirements planning, shop floor control, production orders, product costing etc

- **Quality Management**

  Quality Management is a quality control and information system supporting quality planning, inspection, and control for manufacturing and procurement.

- **Plant Maintenance**

  In a complex manufacturing process, maintenance means more than sweeping the floors. Equipment must be services and rebuilt. These tasks affect the production plans. Plant Maintenance module supports and supervises these maintenance.

- **Warehouse Management**

  Warehouse Management provides flexible, automated support to assist in processing all goods movements and in maintaining current stock inventories in the warehousing complex.

- **Human Resources**

  Human Resources is a complete integrated system for supporting the planning and control of personnel activities.

- **Workflow**

  Workflow is a solution which has been integrated fully in the R/ 3 System and which enables customer-specific business process flows to be coordinated and controlled on a cross-application and cross-workplace basis.

- **Project System**

  Project System is designed to support the planning, control and monitoring of long-term, highly complex projects with defined goals.

2.2.1 Business Scenario–Main Elements of SAP

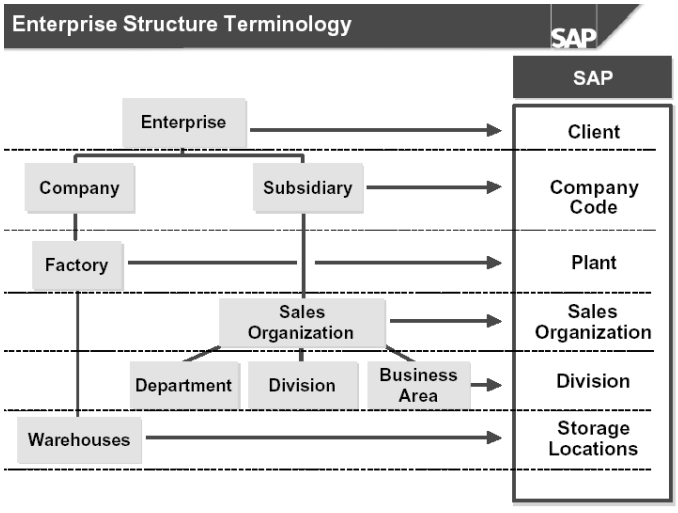
Business Scenario: Business-related grouping of business processes localized in a specific organisational area that share some similar goals in an enterprise, such as purchasing, services, Balance Sheet preparation, production, personnel administration, and so on.

1. Organisation Units
2. Master Data
3. Transactions
4. Documents
5. Reports

1. **Organisational Unit:** Organisational grouping of enterprise areas which, for legal reasons or for other specific business-related reasons or purposes, are grouped together. Organisational units include legal company entities, sales offices, and profit Centres.
2. **Master Data:** Data which is used long-term in the R/ 3 System for several business processes.

   Examples include customers, materials, and vendors.
3. **Transactions:** Application programs which execute business processes in the R/ 3 System such as creating a customer order, posting an incoming payment, or approving a leave request.
4. **Document:** A data record that is generated when a transaction is carried out.
5. **Reports:** Program which reads certain data elements and displays them in a list.

2.2.2 Organisation Units



1. Client

- The highest-level element of all organisational units is the client. The client can be an enterprise group with several subsidiaries. All of the enterprise data in an R/ 3 System implementation is split into at least the client area, and usually into lower level organisational structures as well.
- Clients are used to divide data in a SAP System into various data areas for various purposes. If a company, for example, wants to use its SAP System for both test and training purposes, a client is created for each purpose.
- A client is identified via a three character code starting from 000 to 999. Data can be moved via transports and corrections from one client to another.
- When logging on to the system, the user has to select a client in which he/ she wants to work. The user can then only access data in this client.
- During the investigation we should know that we are accessing the right client. We should never investigate client 000, 001 and 066 as these three clients will never be a Production Client (Live Servers Data)

2. Company Code

- A company code is an independent accounting entity (the smallest organisational element for which a complete self-contained set of accounts can be drawn up). An example is a company within a corporate group. It has a unique, four to six character key.
- The general ledger is kept at the company code level and is used to create the legally required Balance Sheets and profit and loss statements.
- A company code designation is required for every financially based transaction entered into R/ 3. This is done either manually or automatically by deriving the company code from other data elements.

3. Controlling Area

- The Controlling Area is the business unit where Cost Accounting is carried out. Usually there is a 1:1 relationship between the controlling area and the company code. For the purpose of companywide cost accounting, one controlling area can handle cost accounting for several company codes in one enterprise.

4. Sales Organisation

- In the context of Sales and Distribution, the Sales Organisation is central organisational element that controls the terms of sale to the customer. Distribution Channel is the element that describes through what channel goods and/ or services will be distributed to the customer.

5. Distribution Channel

- Distribution Channel—defines different ways of reaching customer

6. Division

- Division–Segment responsibility of products or product line

7. Plant

- In the context of Production Planning and Control, the Plant is the central organisational unit. A plant is the place of production or simply a collection of several locations of material stocks in close physical proximity.

8. Storage Location

- A Storage Location is a storage area comprising warehouses in close proximity. Material stocks can be differentiated within one plant according to storage location (inventory management).

9. Purchasing Organisation

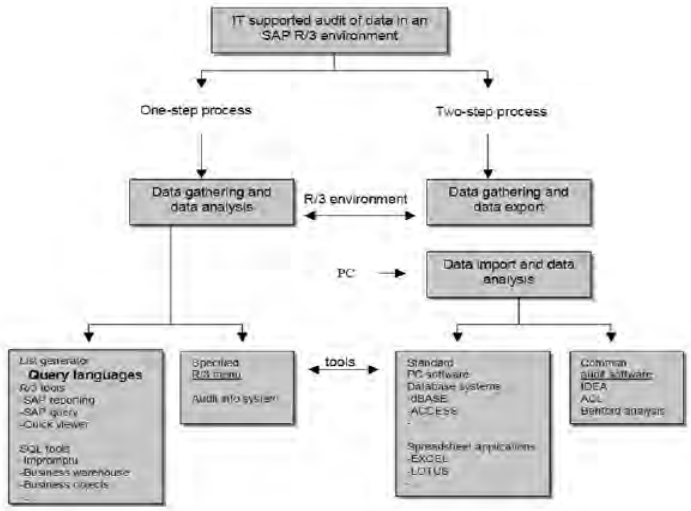
- Unit responsible for procurement of materials and services and negotiates with vendors

10. Purchase Groups

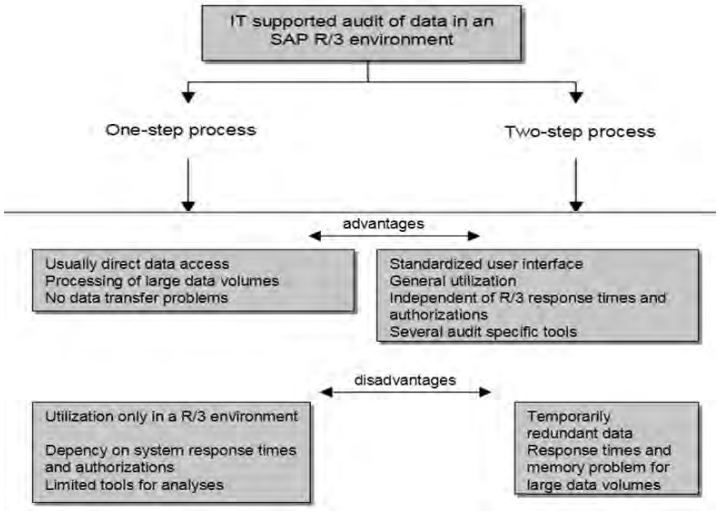
- Buyers responsible for purchases who handles specific group of materials or vendors

2.2.3 SAP Data Types

- **Master Data**
  - o Data that is relatively stable –Materials, Customers, Vendors
- **Transaction Data**
  - o Data that is relatively temporary/ progressive
  - o Stored at various stages of a business process
  - o Customer orders, purchase orders, production orders, customer payments
- **Process of Data Analysis in SAP ERP Environment**
  - o One Step Process
  - o Two Steps Process



Advantages and Disadvantages of One Step Process and Two Steps Process



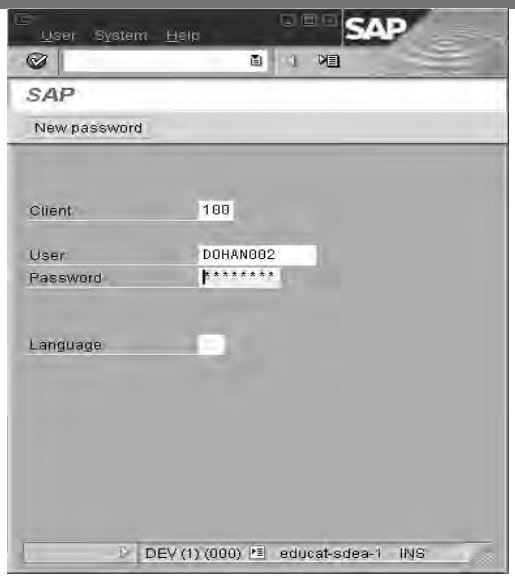
2.3 Navigation

Logging On

- A new window appears
- Enter your user-ID
- Enter your Password

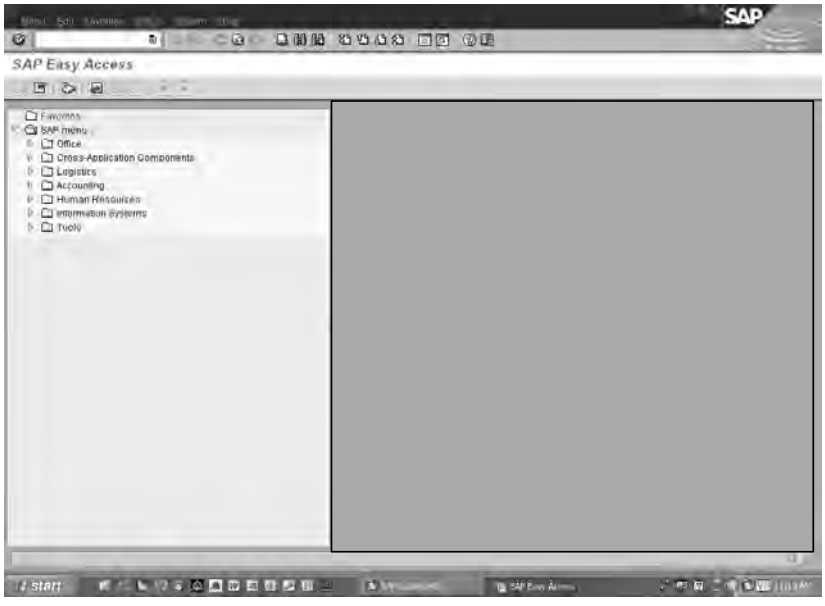
The first time you use SAP you need to reset your password.

- The client number as well as language are entered by your administrator and defaulted
- Press Enter on your keyboard



Main Menu Screen

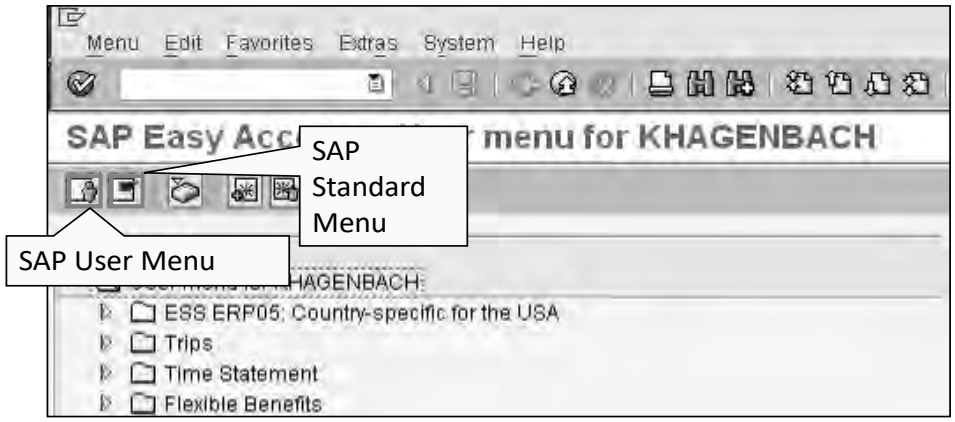
The main menu screen is displayed (standard SAP)



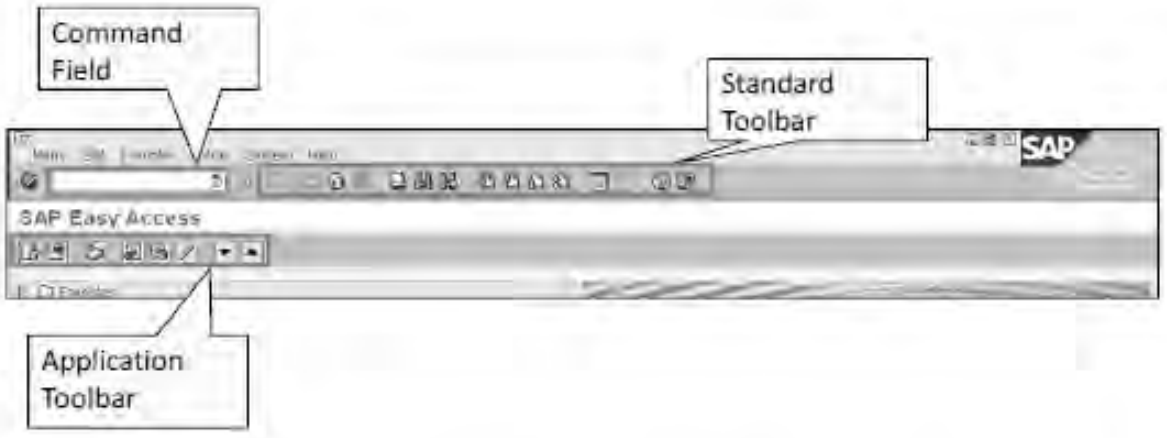
SAP Menus

The default screen is called the *SAP Easy Access* Screen.

- You can switch from one menu to the other by selecting the appropriate icon
- When you log on, you will see either your user menu (specific to your role), or the SAP standard menu (lists all transactions)

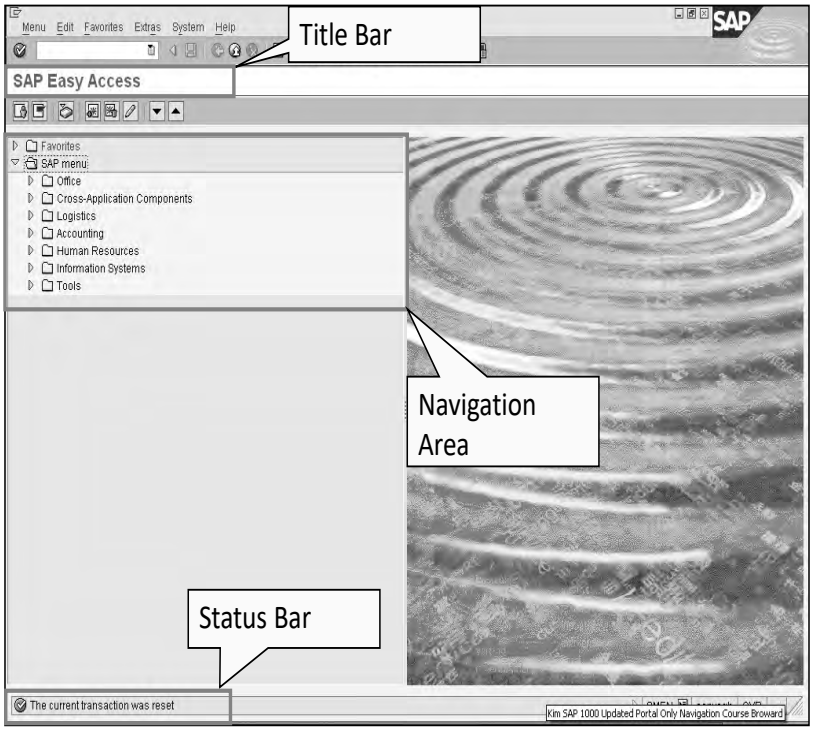


SAP Easy Access Screen and Toolbars

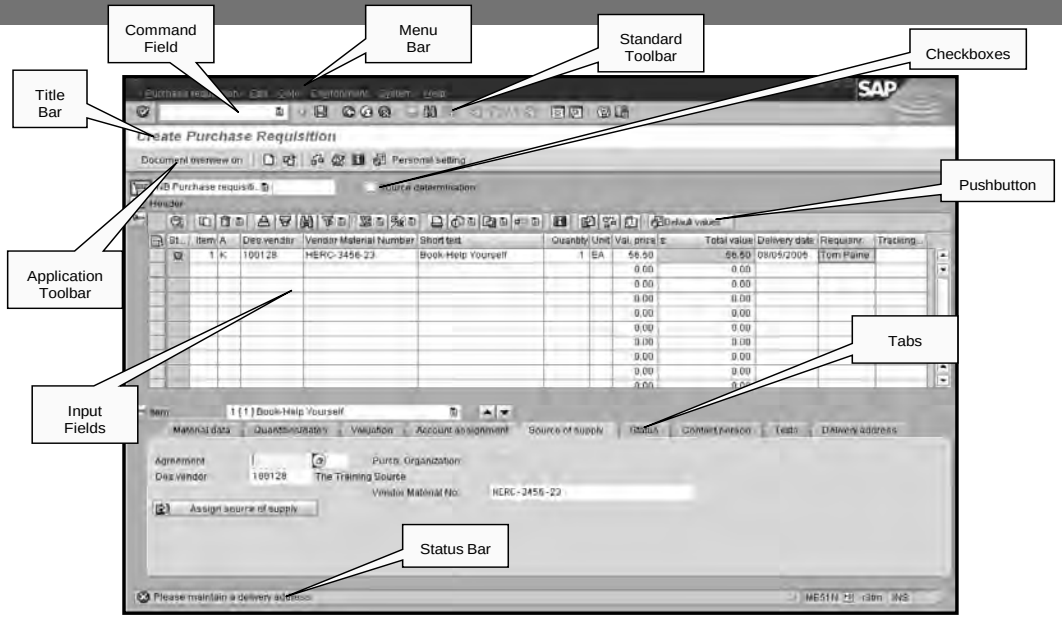


SAP is a Windows-based system. You can navigate in SAP using buttons, toolbars and windows the same way you would in other Windows applications like Word or Excel.

SAP Easy Access Screen



SAP Screen Elements



Transaction in SAP: Transactions let users to create, change, or display data or run a report in SAP. Any activity in SAP is termed as Transaction and every Transaction in SAP is having a code that is known as Transaction Code, in short T-Code.

All the T-Code in SAP starts with an alphabet. All the Standard T-Codes start with A to X. Transaction starting from A to X are standard in nature and having same functionality across all enterprise.

Transaction Code starting from Y or Z are customized transaction code, specific to the enterprise and not standard in nature. All sort of customization can be done with these transaction code. Therefore, during the investigation we should know which transaction report we are getting the data.

Getting Around

There are three ways to access transactions in SAP:

1. Command Field
2. User or SAP menus
3. Favorites

System Messages

Message Type	Code	Message Description
Error Messages		Indicates a problem that must be corrected before continuing.
Information Messages		No action is required. SAP is informing you of a particular fact or condition. However, you must hit Enter to proceed past the message.
Warning Messages		Indicates there may be a problem with the data you have entered. You may have to correct the problem before continuing.

- Train your eye to look at the bottom of the screen for system messages.
- You must correct an error message to proceed.
- You must hit Enter to proceed past a warning message.
- An information message usually appears when you complete a transaction, such as giving you the number of a purchase requisition you just created.

Screen Elements – Status Bar

- The Status Bar displays different types of system-generated messages:
  - Information: Document 100000107 was posted in company code 1001
  - Warning: Terms of payment changed; Check
  - Error: Make an entry in all required fields
- Double-click on the message to display further information

Transaction in SAP: Transactions let users to create, change, or display data or run a report in SAP. Any activity in SAP is termed as Transaction and every Transaction in SAP is having a code that is known as Transaction Code, in short T-Code. All the T-Code in SAP starts with an alphabet. All the Standard T-Codes start with A to X. Transaction starting from A to X are standard in nature and having same functionality across all enterprise.

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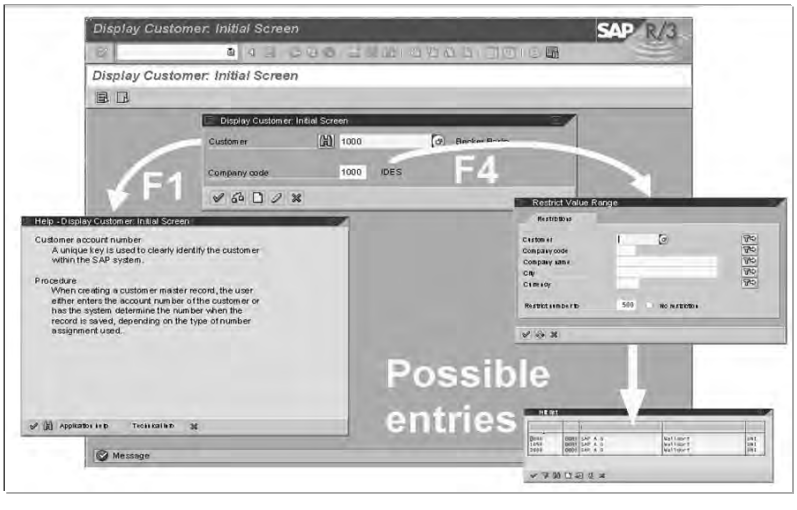
Important Function Key

Important Function Key



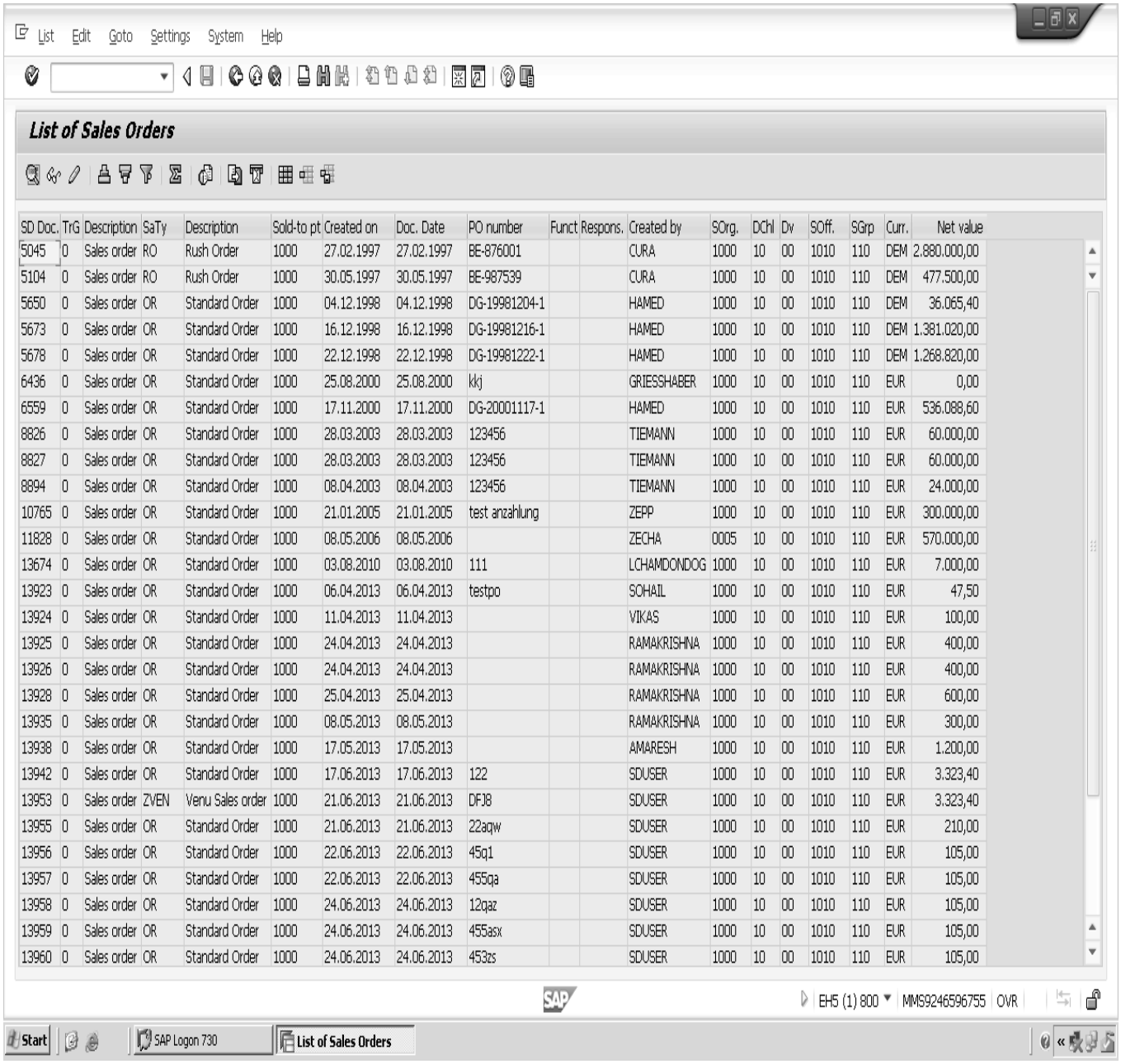
2.4 Standard Reports

All the transaction code starting from A-X are standard T-codes. All the standard reports start from A to X, however any report starting from Y or Z are customized reports for the enterprise and may be modified according to the business guidelines.

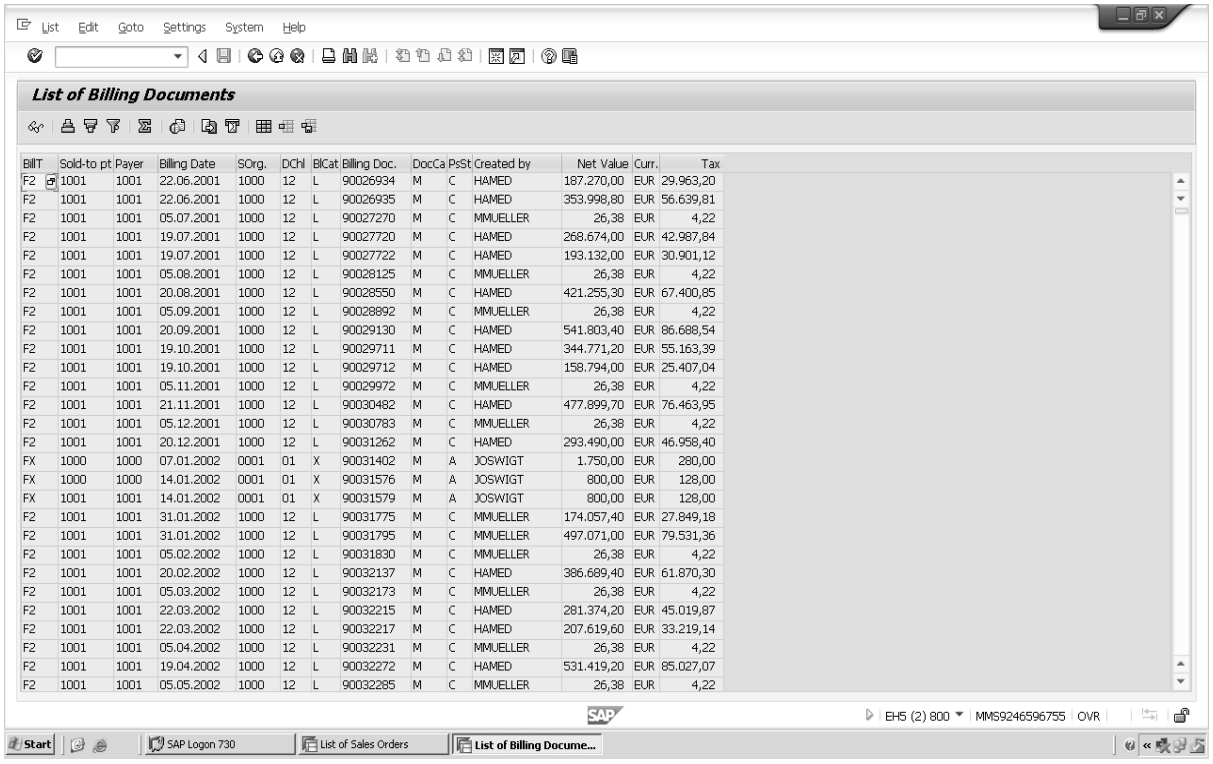
Following are few standard reports and their output along with the screen shots:

2.4.1 Sales and Distribution

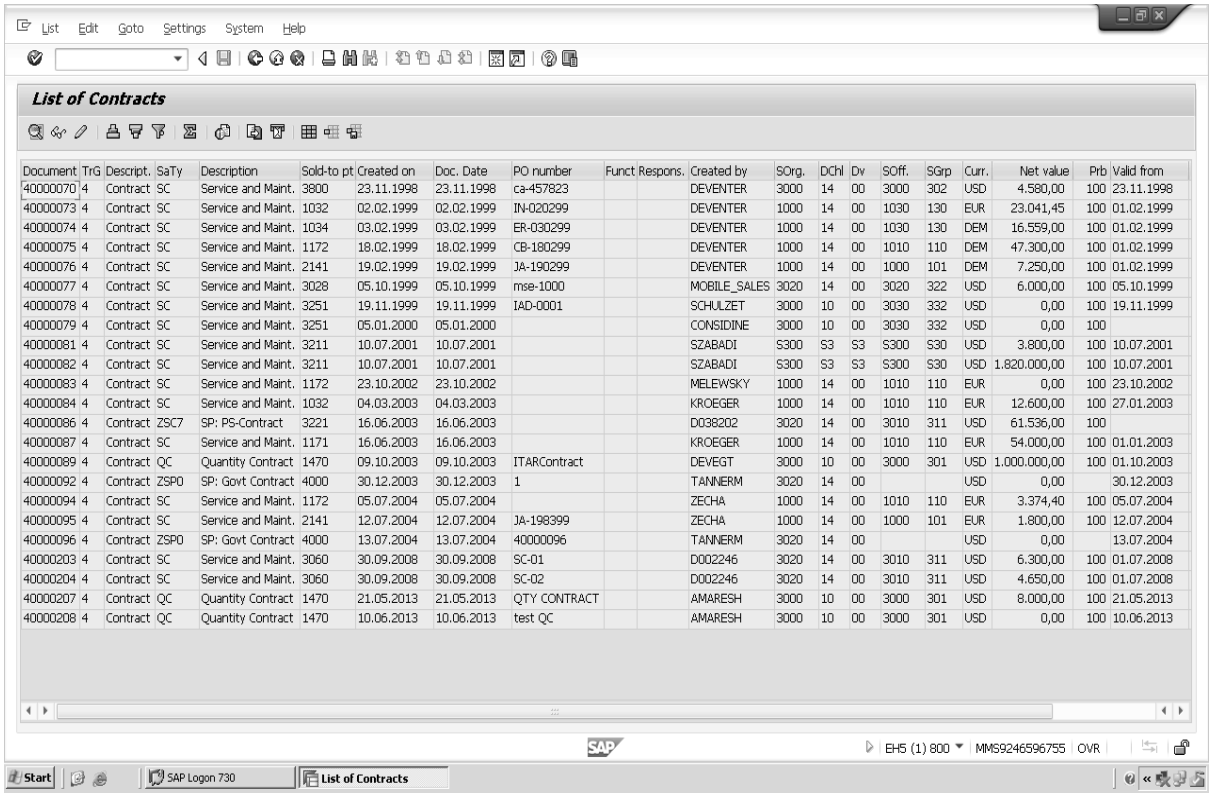
VA05N–List of Sales Order



VF05N–List of Billing Document

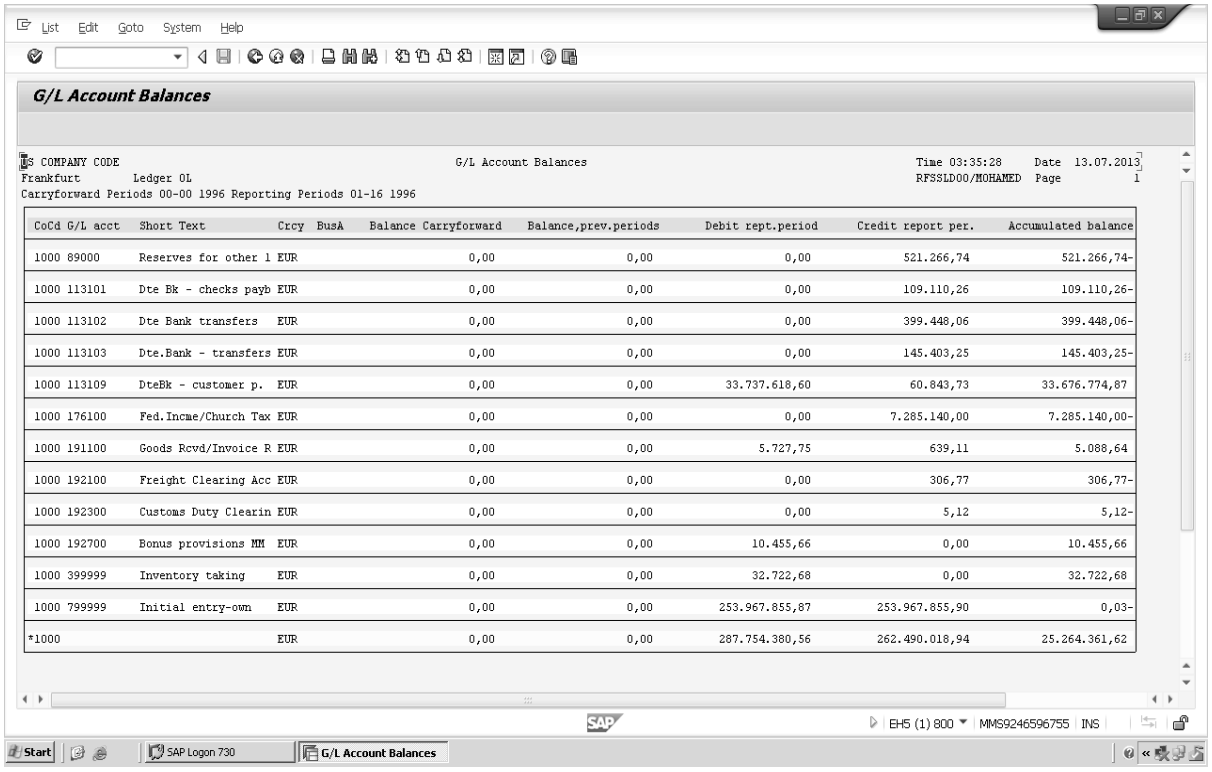


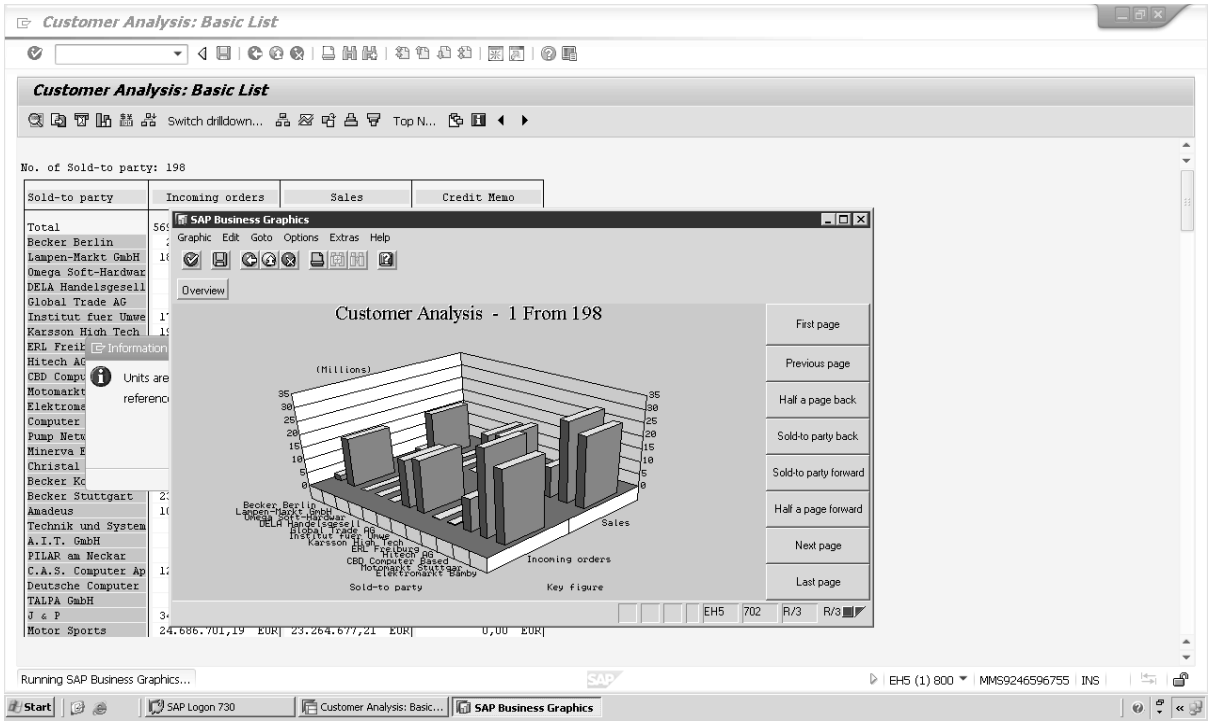
VA45N–List of Contract



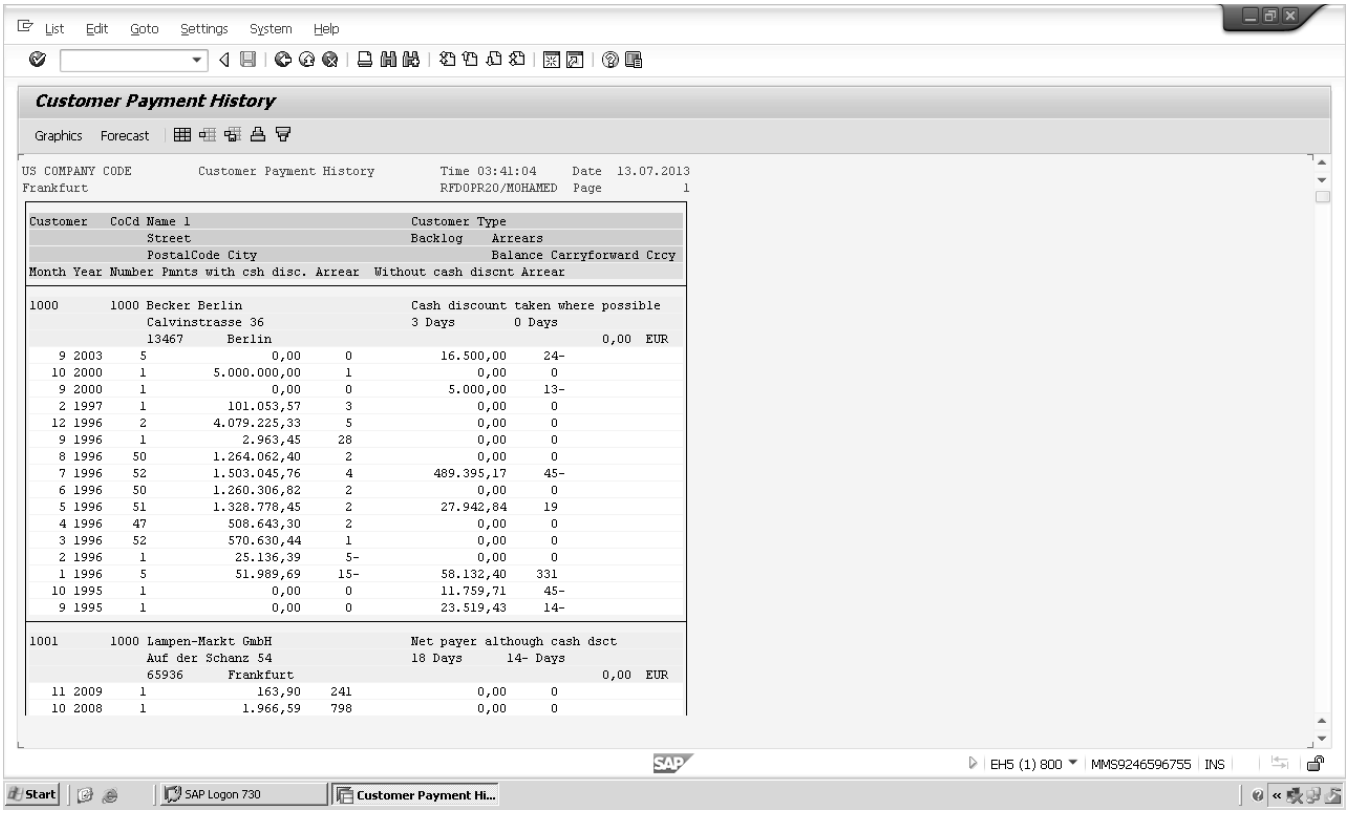
2.4.2 Finance and Controlling

S_ALR_87012277–GL Account Balance

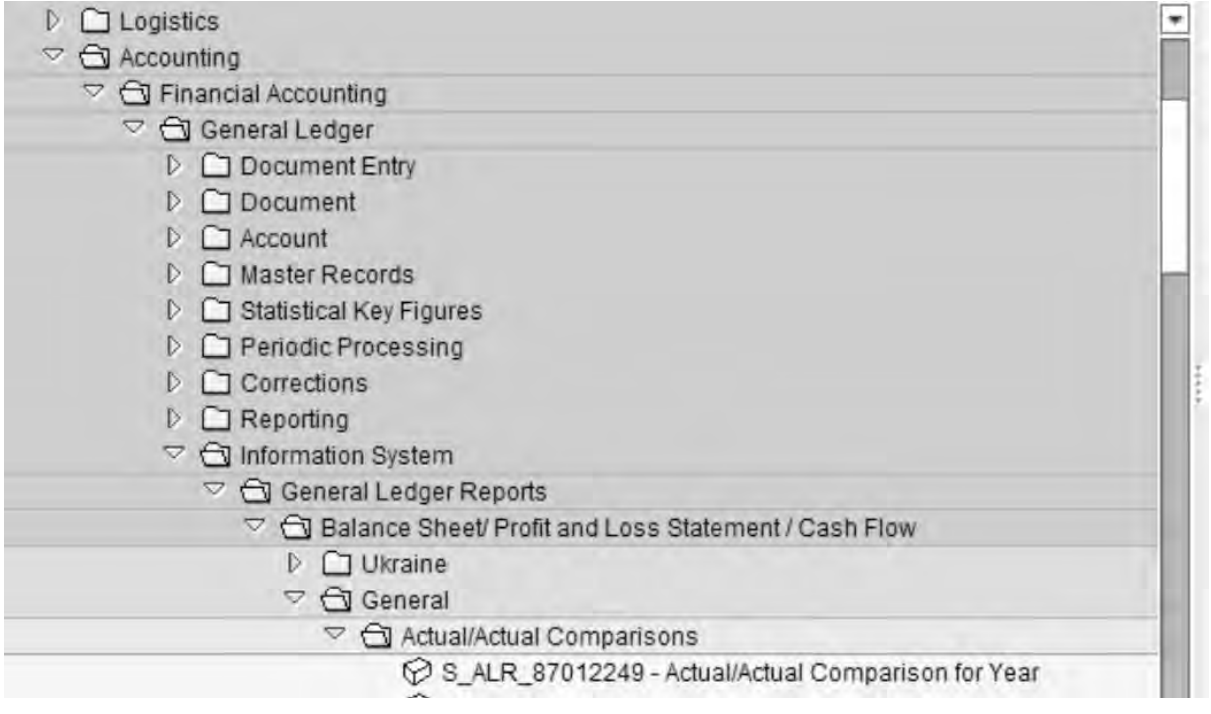


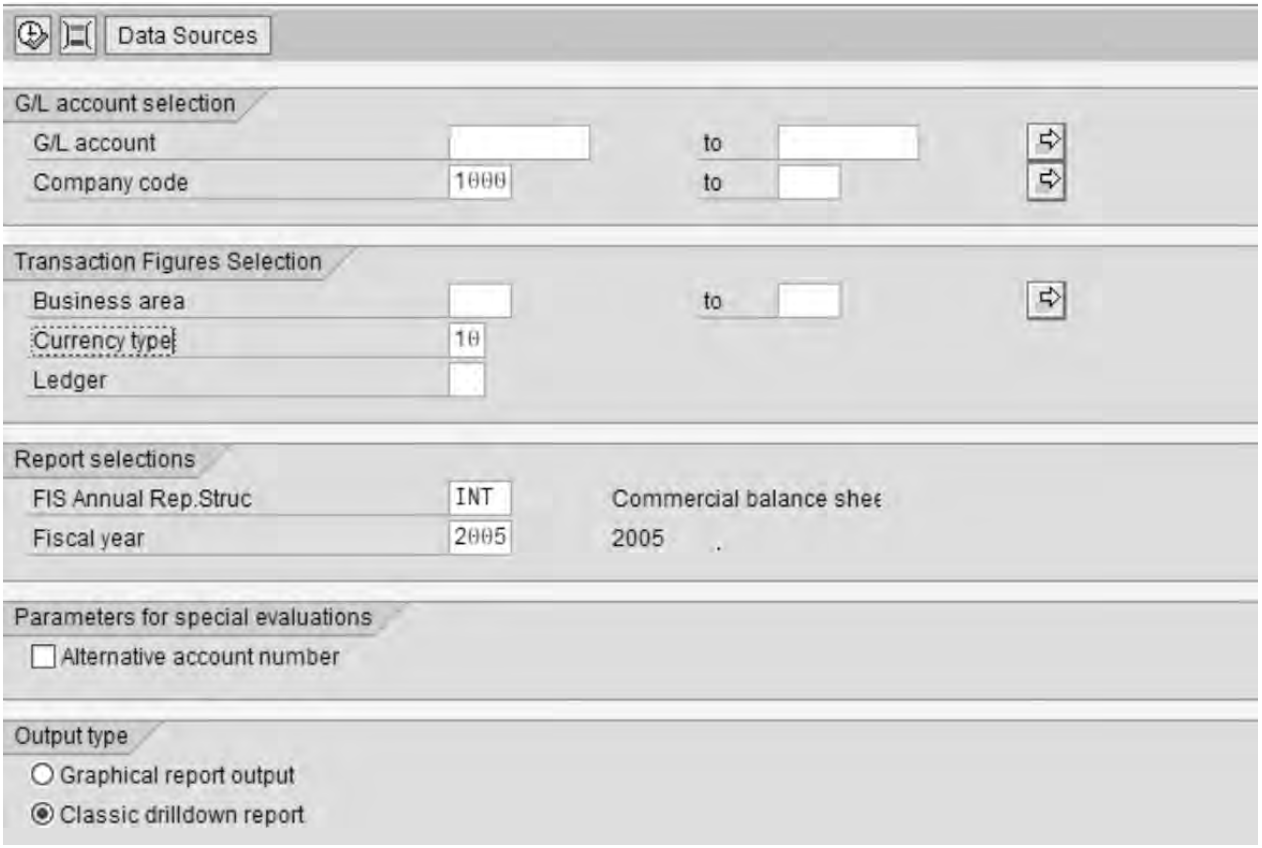


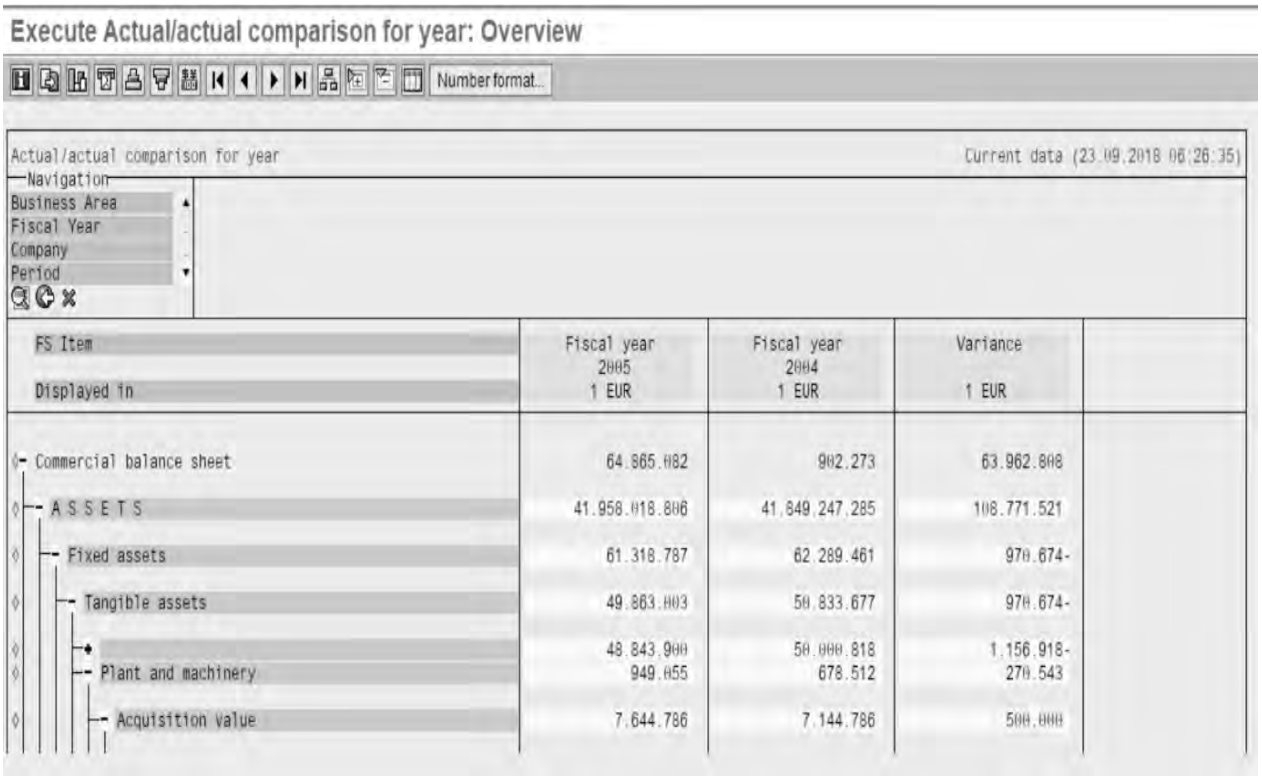
S_ALR_87012177–Customer Payment History



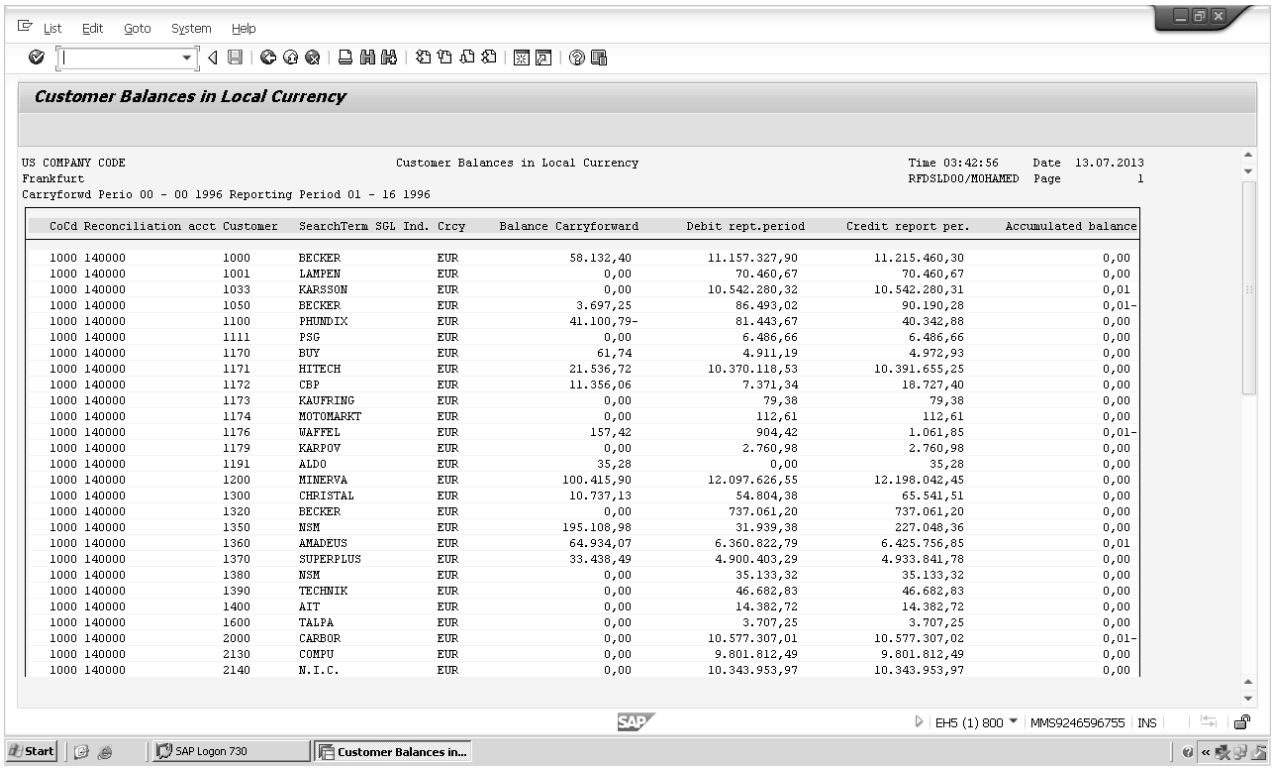
S_ALR_87012249–Balance Sheet/ Profit and Loss Statement/ Cash Flow (Classical Drill Down Report)




Data Sources
G/L account selection
G/L account
to
Company code
1000
to
Transaction Figures Selection
Business area
to
Currency type
10
Ledger
Report selections
FIS Annual Rep.Struc
INT
Commercial balance shee
Fiscal year
2005
2005
Parameters for special evaluations
Alternative account number
Output type
Graphical report output
Classic drilldown report


Execute Actual/actual comparison for year: Overview
Number format...
Actual/actual comparison for year
Current data (23.09.2018 06:26:35)
Navigation
Business Area
Fiscal Year
Company
Period
FS Item
Displayed in
Fiscal year 2005 1 EUR
Fiscal year 2004 1 EUR
Variance 1 EUR
Commercial balance sheet 64.865.082 902.273 63.962.808
A S S E T S 41.958.018.806 41.849.247.285 108.771.521
Fixed assets 61.318.787 62.289.461 970.674-
Tangible assets 49.863.003 50.833.677 970.674-
48.843.900 50.000.818 1.156.918-
Plant and machinery 949.055 678.512 270.543
Acquisition value 7.644.786 7.144.786 500.000

S_ALR_87012172–Customer Balance in Local Currency



List Edit Goto System Help

Customer Balances in Local Currency

US COMPANY CODE — Customer Balances in Local Currency — Time 03:42:56 Date 13.07.2013
Frankfurt — RFDSLD00/MOHAMED Page 1
Carryforwd Perio 00 - 00 1996 Reporting Period 01 - 16 1996

CoCd	Reconciliation acct	Customer	SearchTerm	SGL Ind.	Crcy	Balance Carryforward	Debit rept.period	Credit report per.	Accumulated balance
1000	140000	1000	BECKER		EUR	58.132,40	11.157.327,90	11.215.460,30	0,00
1000	140000	1001	LAMPEN		EUR	0,00	70.460,67	70.460,67	0,00
1000	140000	1033	KARSSON		EUR	0,00	10.542.280,32	10.542.280,31	0,01
1000	140000	1050	BECKER		EUR	3.697,25	86.493,02	90.190,28	0,01-
1000	140000	1100	PHUNDIX		EUR	41.100,79-	81.443,67	40.342,88	0,00
1000	140000	1111	PSG		EUR	0,00	6.486,66	6.486,66	0,00
1000	140000	1170	BUY		EUR	61,74	4.911,19	4.972,93	0,00
1000	140000	1171	HITECH		EUR	21.536,72	10.370.118,53	10.391.655,25	0,00
1000	140000	1172	CBP		EUR	11.356,06	7.371,34	18.727,40	0,00
1000	140000	1173	KAUFRING		EUR	0,00	79,38	79,38	0,00
1000	140000	1174	MOTOMARKT		EUR	0,00	112,61	112,61	0,00
1000	140000	1176	WAFFEL		EUR	157,42	904,42	1.061,85	0,01-
1000	140000	1179	KARPOV		EUR	0,00	2.760,98	2.760,98	0,00
1000	140000	1191	ALDO		EUR	35,28	0,00	35,28	0,00
1000	140000	1200	MINERVA		EUR	100.415,90	12.097.626,55	12.198.042,45	0,00
1000	140000	1300	CHRISTAL		EUR	10.737,13	54.804,38	65.541,51	0,00
1000	140000	1320	BECKER		EUR	0,00	737.061,20	737.061,20	0,00
1000	140000	1350	NSM		EUR	195.108,98	31.939,38	227.048,36	0,00
1000	140000	1360	AMADEUS		EUR	64.934,07	6.360.822,79	6.425.756,85	0,01
1000	140000	1370	SUPERPLUS		EUR	33.438,49	4.900.403,29	4.933.841,78	0,00
1000	140000	1380	NSM		EUR	0,00	35.133,32	35.133,32	0,00
1000	140000	1390	TECHNIK		EUR	0,00	46.682,83	46.682,83	0,00
1000	140000	1400	AIT		EUR	0,00	14.382,72	14.382,72	0,00
1000	140000	1600	TALPA		EUR	0,00	3.707,25	3.707,25	0,00
1000	140000	2000	CARBOR		EUR	0,00	10.577.307,01	10.577.307,02	0,01-
1000	140000	2130	COMPU		EUR	0,00	9.801.812,49	9.801.812,49	0,00
1000	140000	2140	N.I.C.		EUR	0,00	10.343.953,97	10.343.953,97	0,00

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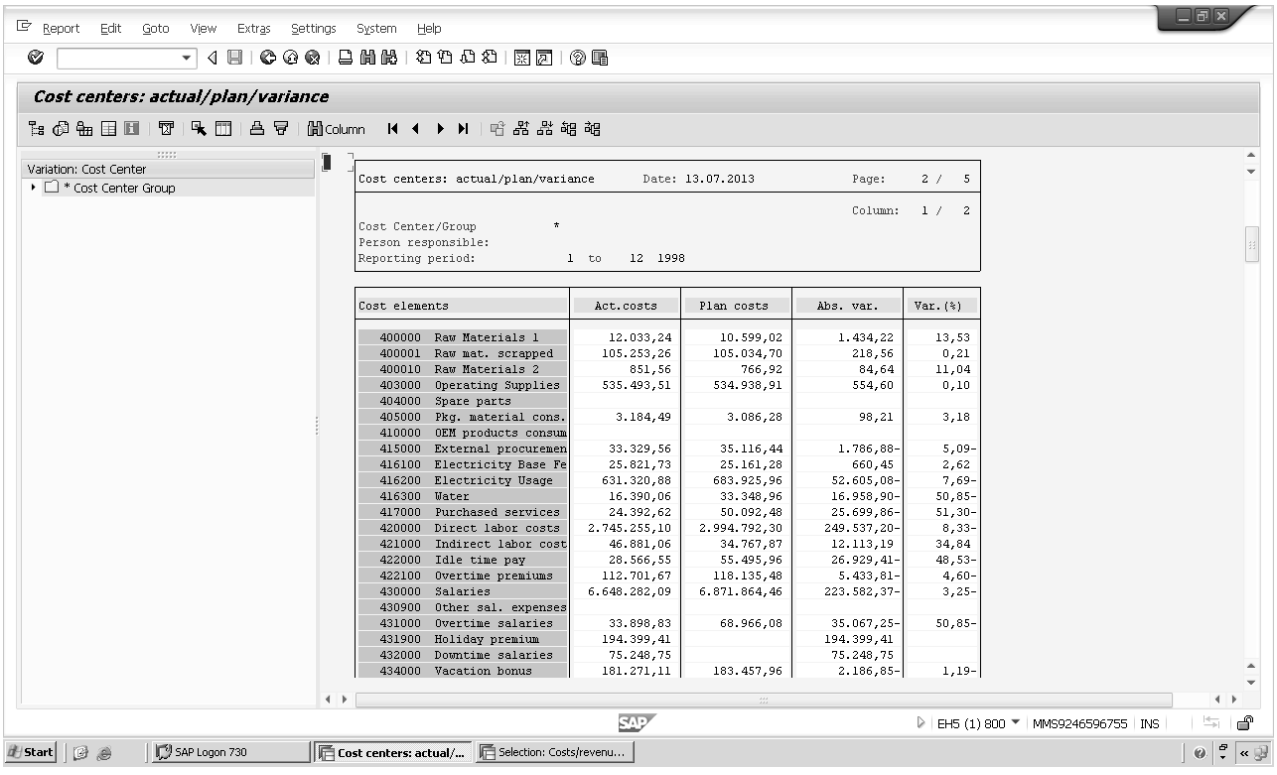
Start | SAP Logon 730 | Customer Balances in...

S_ALR_87013611 - Cost centre accounting - Plan/ Actual comparison



Report Edit Goto View Extras Settings System Help

Cost centers: actual/plan/variance

Column

Variation: Cost Center
* Cost Center Group

Cost centers: actual/plan/variance Date: 13.07.2013 Page: 2 / 5
Column: 1 / 2
Cost Center/Group *
Person responsible:
Reporting period: 1 to 12 1998

Cost elements		Act.costs	Plan costs	Abs. var.	Var.(%)
400000	Raw Materials 1	12.033,24	10.599,02	1.434,22	13,53
400001	Raw mat. scrapped	105.253,26	105.034,70	218,56	0,21
400010	Raw Materials 2	851,56	766,92	84,64	11,04
403000	Operating Supplies	535.493,51	534.938,91	554,60	0,10
404000	Spare parts				
405000	Pkg. material cons.	3.184,49	3.086,28	98,21	3,18
410000	OEM products consum				
415000	External procuremen	33.329,56	35.116,44	1.786,88-	5,09-
416100	Electricity Base Fe	25.821,73	25.161,28	660,45	2,62
416200	Electricity Usage	631.320,88	683.925,96	52.605,08-	7,69-
416300	Water	16.390,06	33.348,96	16.958,90-	50,85-
417000	Purchased services	24.392,62	50.092,48	25.699,86-	51,30-
420000	Direct labor costs	2.745.255,10	2.994.792,30	249.537,20-	8,33-
421000	Indirect labor cost	46.881,06	34.767,87	12.113,19	34,84
422000	Idle time pay	28.566,55	55.495,96	26.929,41-	48,53-
422100	Overtime premiums	112.701,67	118.135,48	5.433,81-	4,60-
430000	Salaries	6.648.282,09	6.871.864,46	223.582,37-	3,25-
430900	Other sal. expenses				
431000	Overtime salaries	33.898,83	68.966,08	35.067,25-	50,85-
431900	Holiday premium	194.399,41		194.399,41	
432000	Downtime salaries	75.248,75		75.248,75	
434000	Vacation bonus	181.271,11	183.457,96	2.186,85-	1,19-

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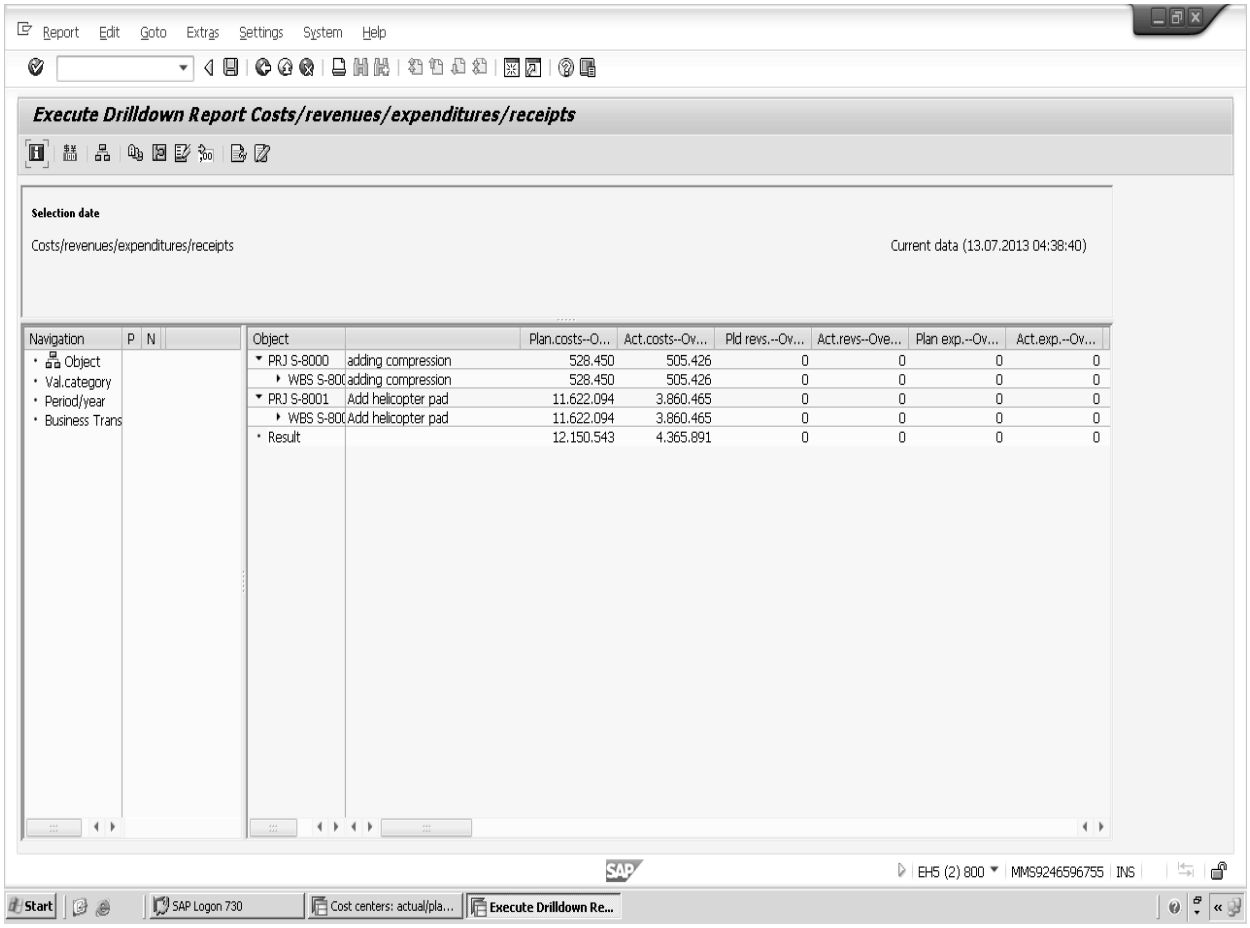
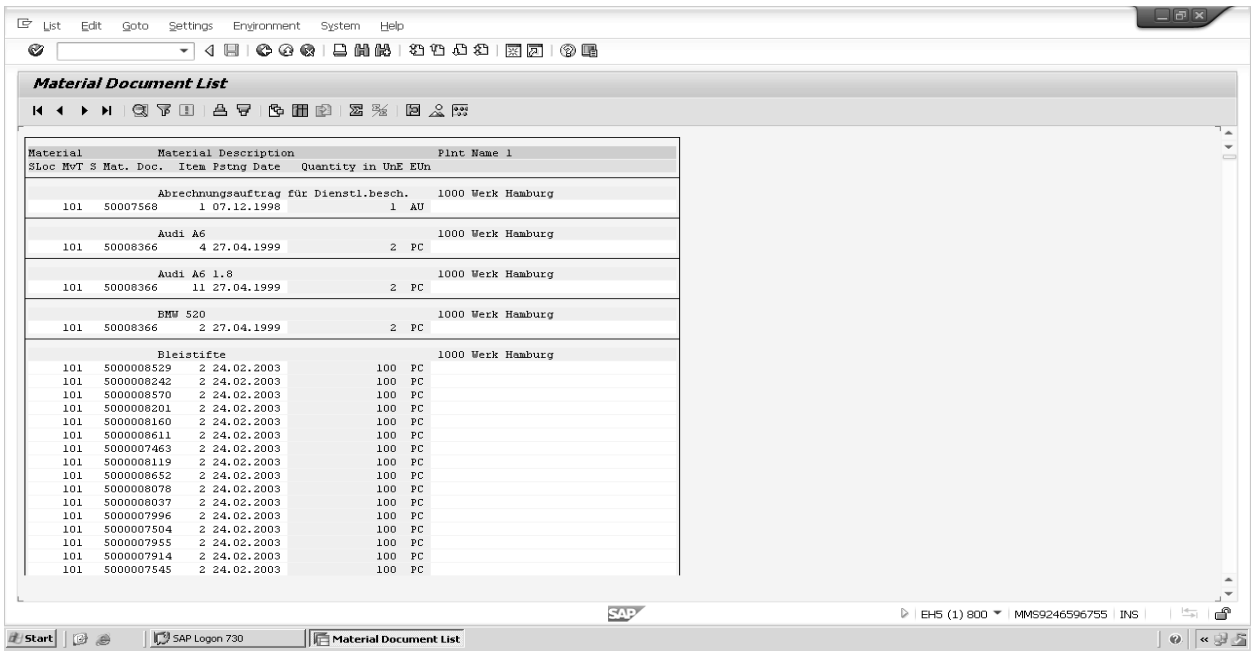
Start | SAP Logon 730 | Cost centers: actual/... | Selection: Costs/revenu...

2.4.3 Project System

S_ALR_87013531 - Project cost/ revenue/ expenditure

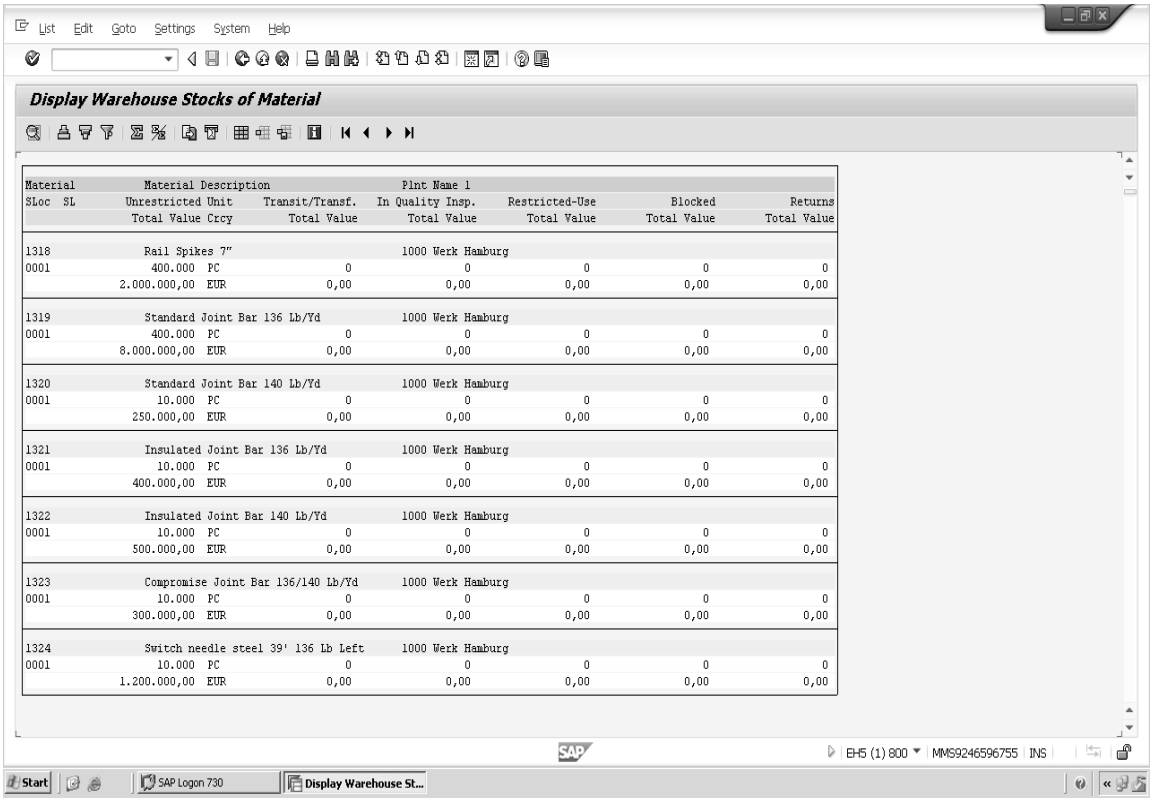




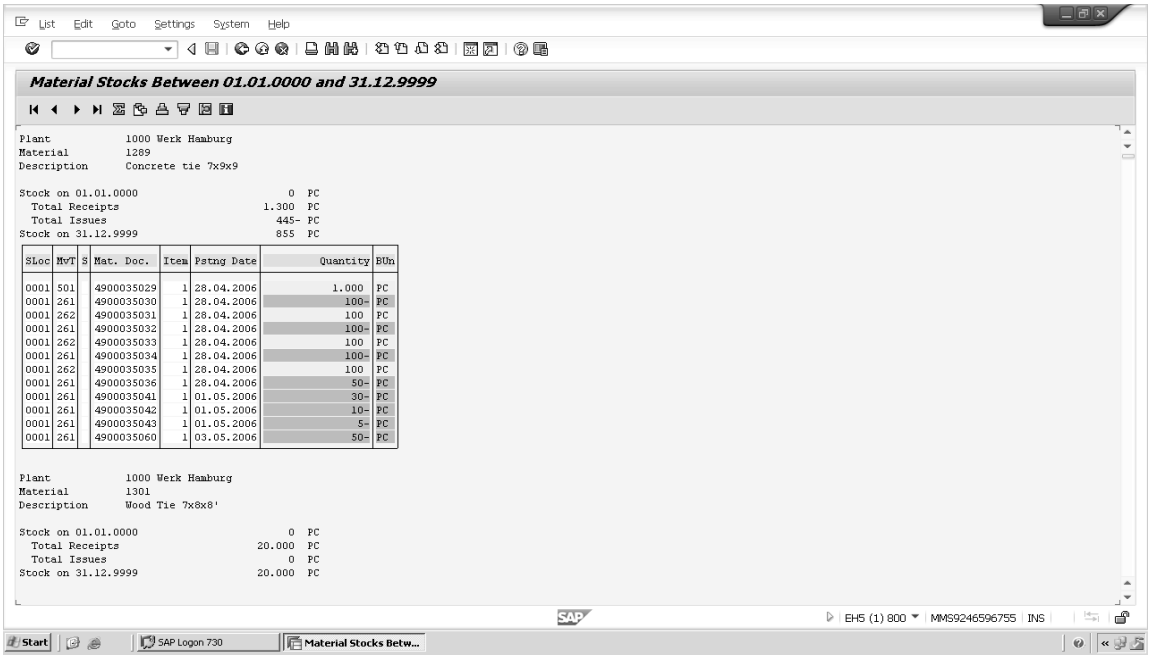
2.4.4 Material Management–Inventory Management

MB51–Material Document List–Movement of Material Report

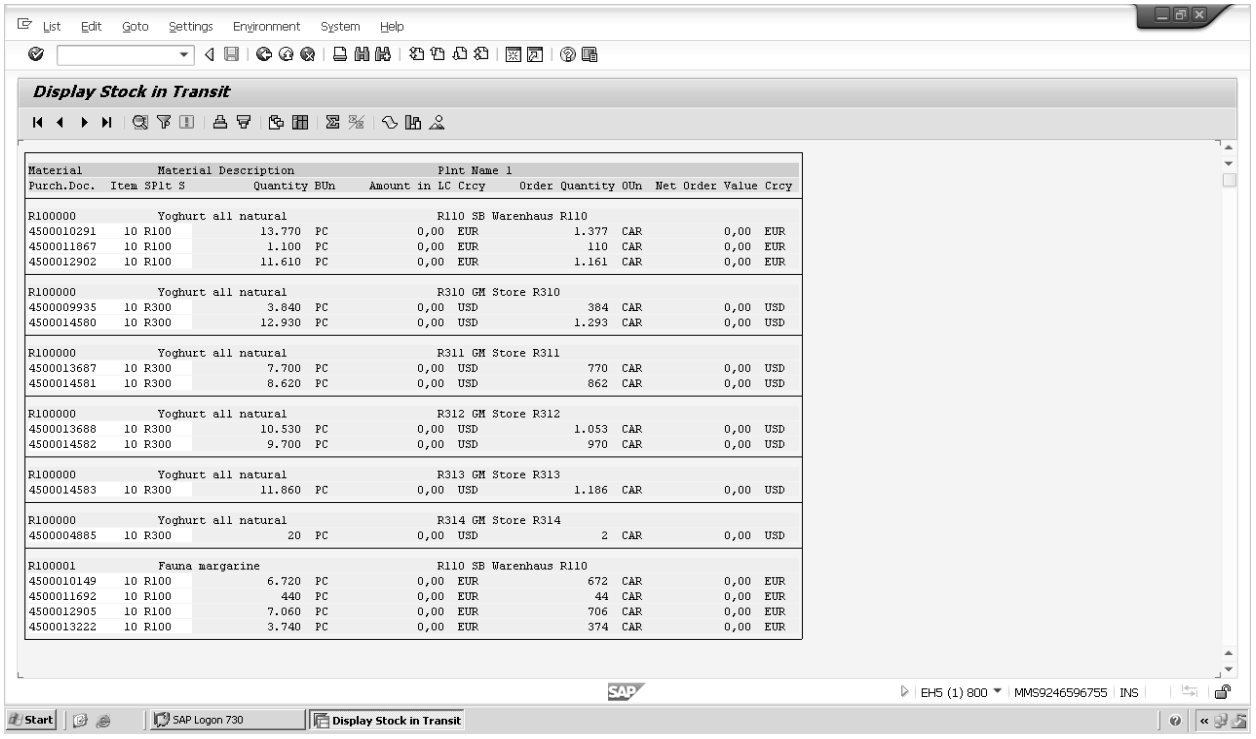
MB52–Plant Stock Availability



MB5B–Stock on Posting Date



MB5T–Stock in Transit



List Edit Goto Settings Environment System Help

Display Stock in Transit

Material / Purch.Doc.	Item	SPlt	S	Material Description / Quantity	BUn	Amount in LC	Crcy	Plnt Name 1 / Order Quantity	OUn	Net Order Value	Crcy
R100000				Yoghurt all natural				R110 SB Warenhaus R110			
4500010291	10	R100		13.770	PC	0,00	EUR	1.377	CAR	0,00	EUR
4500011867	10	R100		1.100	PC	0,00	EUR	110	CAR	0,00	EUR
4500012902	10	R100		11.610	PC	0,00	EUR	1.161	CAR	0,00	EUR
R100000				Yoghurt all natural				R310 GM Store R310			
4500009935	10	R300		3.840	PC	0,00	USD	384	CAR	0,00	USD
4500014580	10	R300		12.930	PC	0,00	USD	1.293	CAR	0,00	USD
R100000				Yoghurt all natural				R311 GM Store R311			
4500013687	10	R300		7.700	PC	0,00	USD	770	CAR	0,00	USD
4500014581	10	R300		8.620	PC	0,00	USD	862	CAR	0,00	USD
R100000				Yoghurt all natural				R312 GM Store R312			
4500013688	10	R300		10.530	PC	0,00	USD	1.053	CAR	0,00	USD
4500014582	10	R300		9.700	PC	0,00	USD	970	CAR	0,00	USD
R100000				Yoghurt all natural				R313 GM Store R313			
4500014583	10	R300		11.860	PC	0,00	USD	1.186	CAR	0,00	USD
R100000				Yoghurt all natural				R314 GM Store R314			
4500004885	10	R300		20	PC	0,00	USD	2	CAR	0,00	USD
R100001				Fauna margarine				R110 SB Warenhaus R110			
4500010149	10	R100		6.720	PC	0,00	EUR	672	CAR	0,00	EUR
4500011692	10	R100		440	PC	0,00	EUR	44	CAR	0,00	EUR
4500012905	10	R100		7.060	PC	0,00	EUR	706	CAR	0,00	EUR
4500013222	10	R100		3.740	PC	0,00	EUR	374	CAR	0,00	EUR

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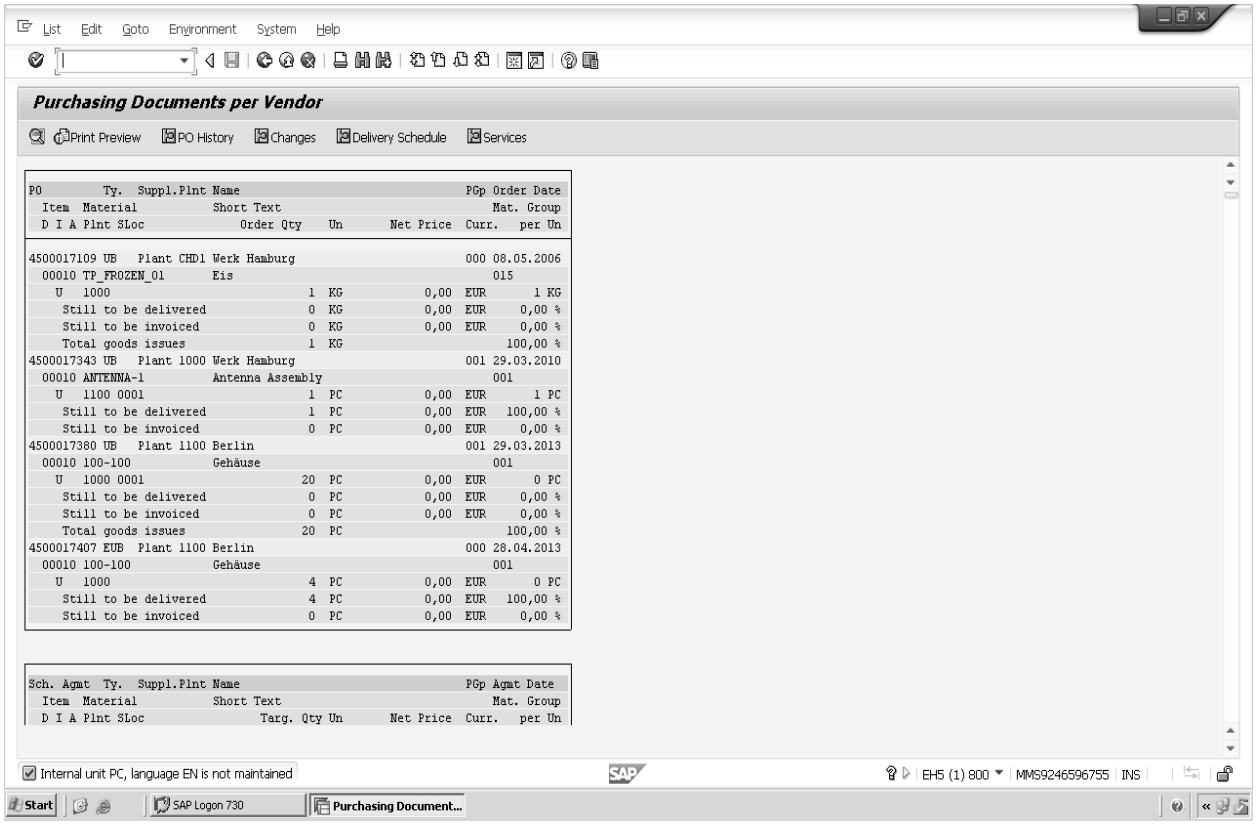
Start | SAP Logon 730 | Display Stock in Transit

ME2L–Purchase Order Display



List Edit Goto Environment System Help

Purchasing Documents per Vendor

Print Preview | PO History | Changes | Delivery Schedule | Services

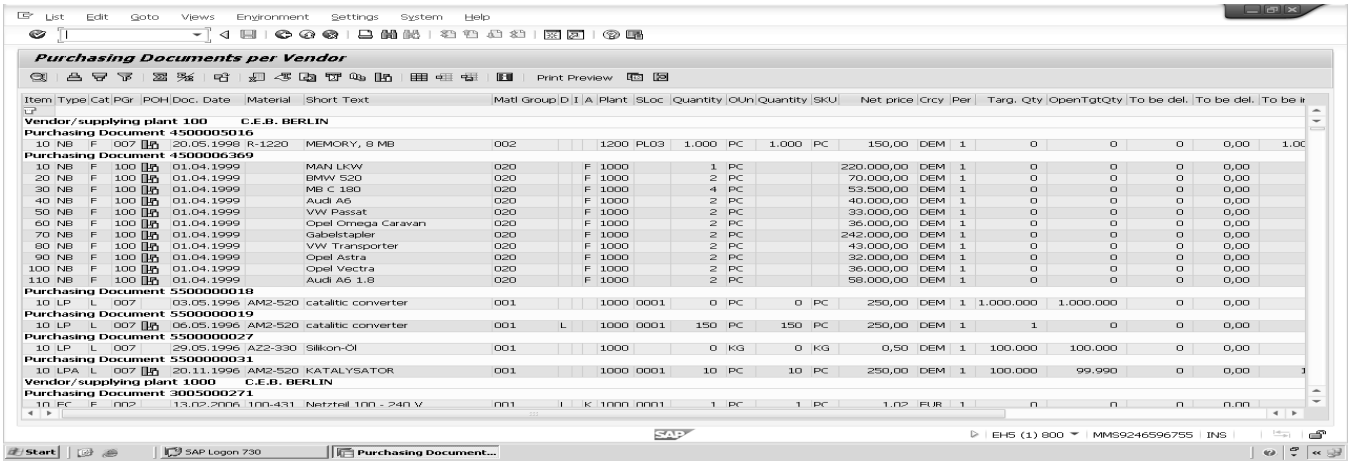
PO / Item	Ty. / Material	Suppl.Plnt / Short Text	Name	PGp / Mat. Group	Order Date
D I A	Plnt SLoc	Order Qty	Un	Net Price	Curr.	per Un
4500017109	UB	Plant CHD1	Werk Hamburg	000	08.05.2006
00010	TP_FROZEN_01	Eis		015	
U	1000	1	KG	0,00	EUR	1 KG
	Still to be delivered	0	KG	0,00	EUR	0,00 %
	Still to be invoiced	0	KG	0,00	EUR	0,00 %
	Total goods issues	1	KG			100,00 %
4500017343	UB	Plant 1000	Werk Hamburg	001	29.03.2010
00010	ANTENNA-1	Antenna Assembly		001	
U	1100 0001	1	PC	0,00	EUR	1 PC
	Still to be delivered	1	PC	0,00	EUR	100,00 %
	Still to be invoiced	0	PC	0,00	EUR	0,00 %
4500017380	UB	Plant 1100	Berlin	001	29.03.2013
00010	100-100	Gehäuse		001	
U	1000 0001	20	PC	0,00	EUR	0 PC
	Still to be delivered	0	PC	0,00	EUR	0,00 %
	Still to be invoiced	0	PC	0,00	EUR	0,00 %
	Total goods issues	20	PC			100,00 %
4500017407	EUB	Plant 1100	Berlin	000	28.04.2013
00010	100-100	Gehäuse		001	
U	1000	4	PC	0,00	EUR	0 PC
	Still to be delivered	4	PC	0,00	EUR	100,00 %
	Still to be invoiced	0	PC	0,00	EUR	0,00 %

Sch. Agmt / Item	Ty. / Material	Suppl.Plnt / Short Text	Name	PGp / Mat. Group	Agmt Date
D I A	Plnt SLoc	Targ. Qty	Un	Net Price	Curr.	per Un

Internal unit PC, language EN is not maintained

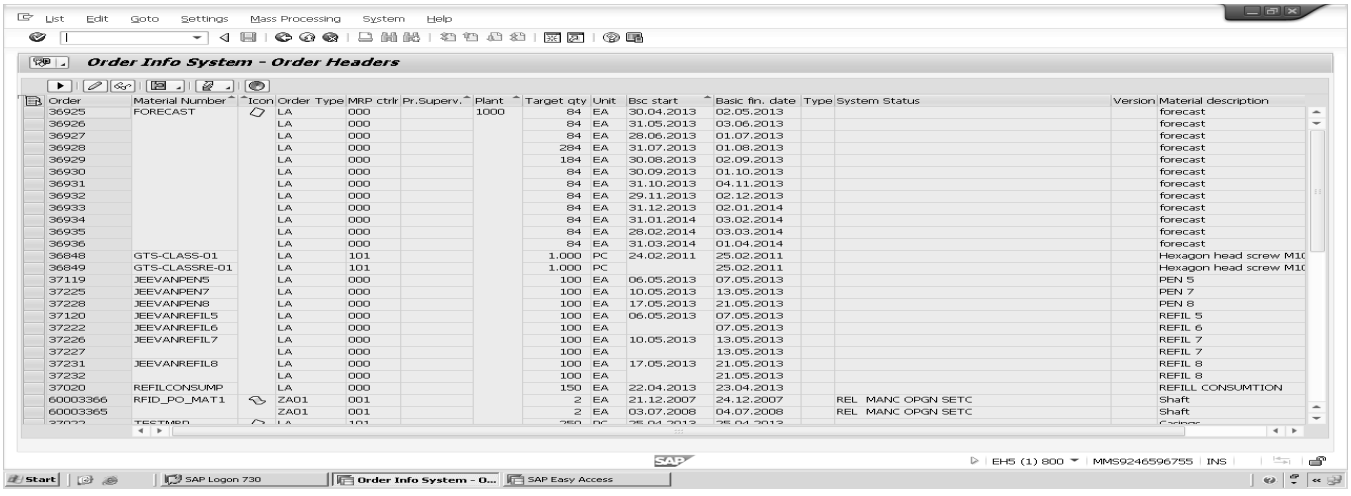
EH5 (1) 800 | MMS9246596755 | INS

Start | SAP Logon 730 | Purchasing Document...



2.5 Production

COOIS–Production Order Information System



2.6 Chart of Account for Financial Audit

2.6.1 Chart of Account

2.6.2 Definition

The Chart of Account in SAP (COA) is a list of GL Accounts master records that are used by the organisation. The master chart of accounts must be assigned to each company code. Chart of account is defined at client level. A chart of accounts is a financial organisation tool that provides a complete listing of every account in an accounting system.

An account is a unique record for each type of asset, liability, equity, revenue and expense.

2.6.3 Types of Chart of Accounts

1. Operating Chart of Accounts
2. Group Chart of Accounts
3. Country Specific Chart of Accounts

The three different Charts of Accounts have three different functions in the system

1. **Operating Chart of Accounts**
   - The operating chart of accounts contains G/L accounts that we use for posting in the company code during daily activities. Financial Accounting and Controlling both use this chart of Accounts.
   - We have to assign an operating chart of accounts to a company code.
2. **Group Chart of Accounts**
   - The Group Chart of Accounts contains the G/L accounts that are used by the entire corporate group. This allows the company to provide reports for the entire corporate group.
   - The assigning of a corporate group chart of accounts to a company code is optional.
3. **Country-specific Chart of Accounts**
   - The country-specific chart of accounts contains the G/L accounts need to meet the country's legal requirements. This allows us to provide statements for the country's legal requirements.
   - The assigning of the country-specific chart of accounts to a company code is optional

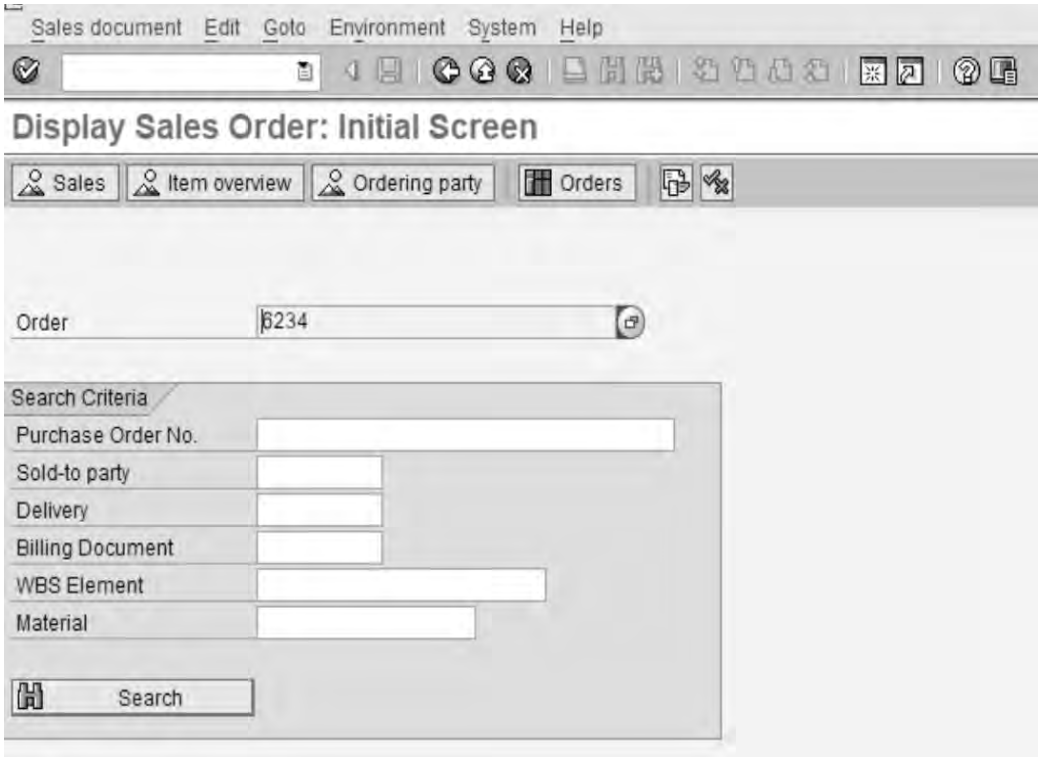
2.7 Audit Trail and Fraud Finding

SAP is having the most robust database and excellent software for Auditors. During the investigation there are two ways to do the audit.

1. **Auditing individual Document for the amendments done in any document.**

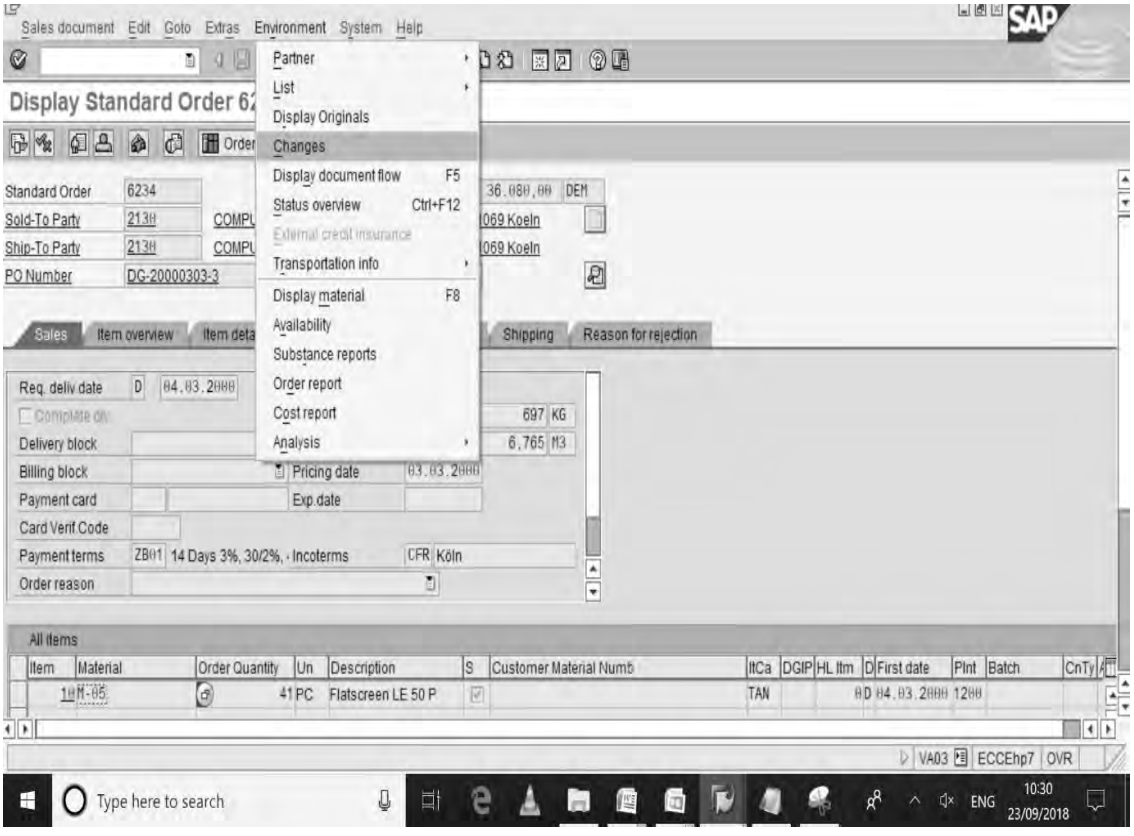
In order to do this we need to login into the document and follow the following steps:

E.g. –Suppose there is some changes being done in the Sales Order and during the investigation we would like to know the amendment done in the sales order, we run the T-Code–VA03 (Display Sales Order)

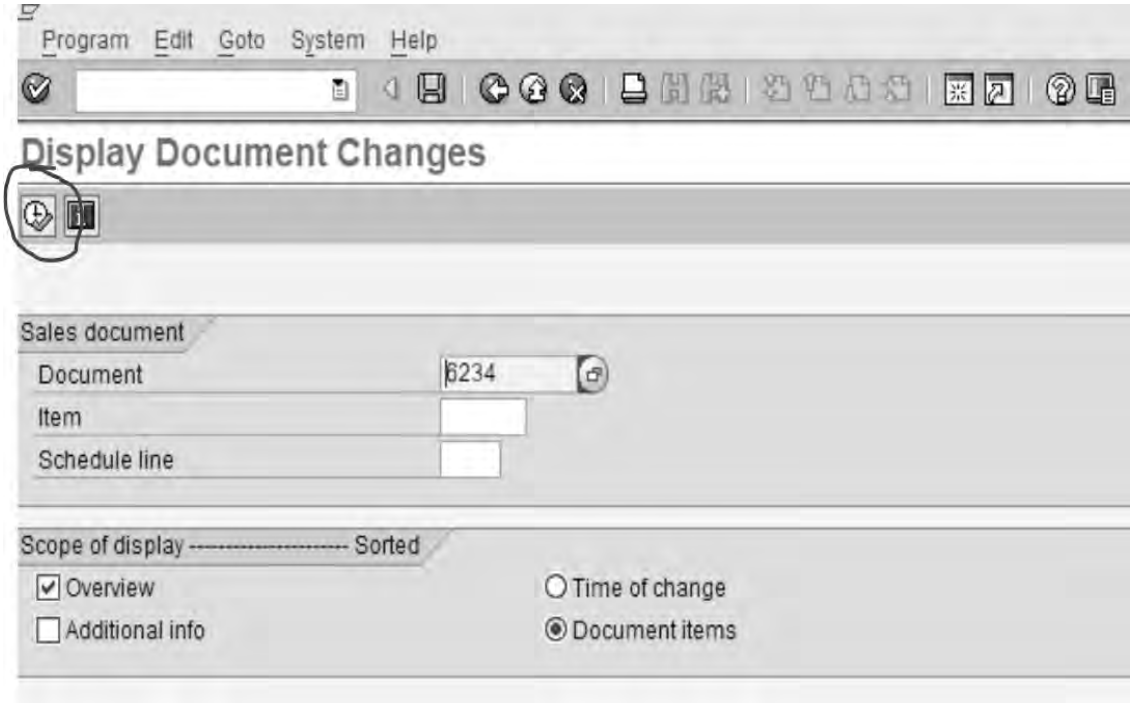


Input the Sales Order number in the order field, in this example it is 6234 and press enter.

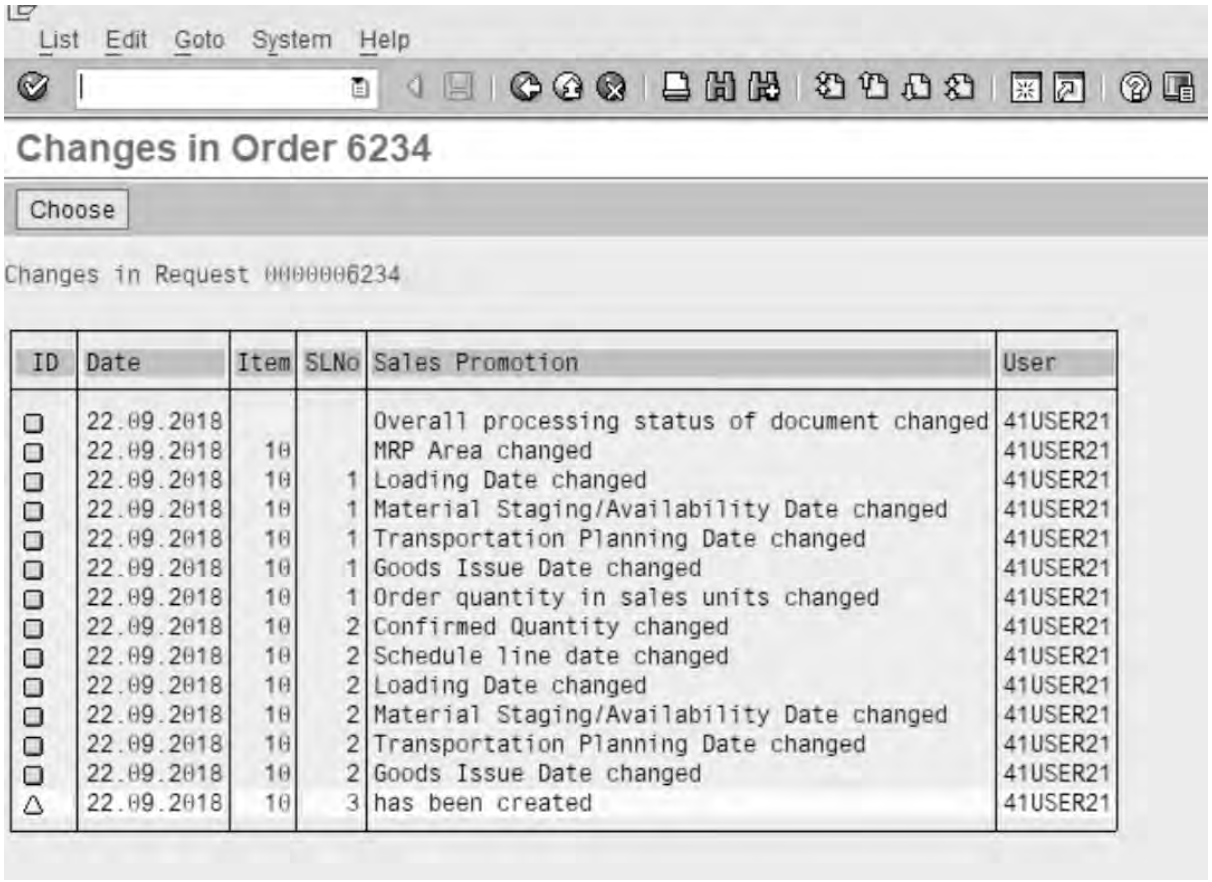
Then go to environment and changes



Then click at execute button in the application tool bar.

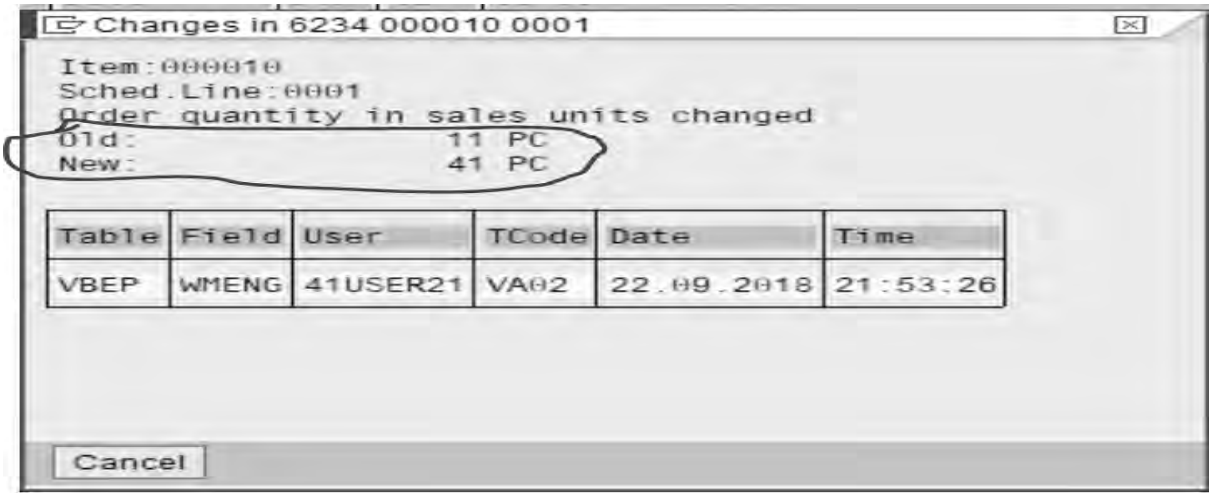


It will show all the changes in the Sales Order specific to the order



ID	Date	Item	SLNo	Sales Promotion	User
☐	22.09.2018			Overall processing status of document changed	41USER21
☐	22.09.2018	10		MRP Area changed	41USER21
☐	22.09.2018	10	1	Loading Date changed	41USER21
☐	22.09.2018	10	1	Material Staging/Availability Date changed	41USER21
☐	22.09.2018	10	1	Transportation Planning Date changed	41USER21
☐	22.09.2018	10	1	Goods Issue Date changed	41USER21
☐	22.09.2018	10	1	Order quantity in sales units changed	41USER21
☐	22.09.2018	10	2	Confirmed Quantity changed	41USER21
☐	22.09.2018	10	2	Schedule line date changed	41USER21
☐	22.09.2018	10	2	Loading Date changed	41USER21
☐	22.09.2018	10	2	Material Staging/Availability Date changed	41USER21
☐	22.09.2018	10	2	Transportation Planning Date changed	41USER21
☐	22.09.2018	10	2	Goods Issue Date changed	41USER21
△	22.09.2018	10	3	has been created	41USER21

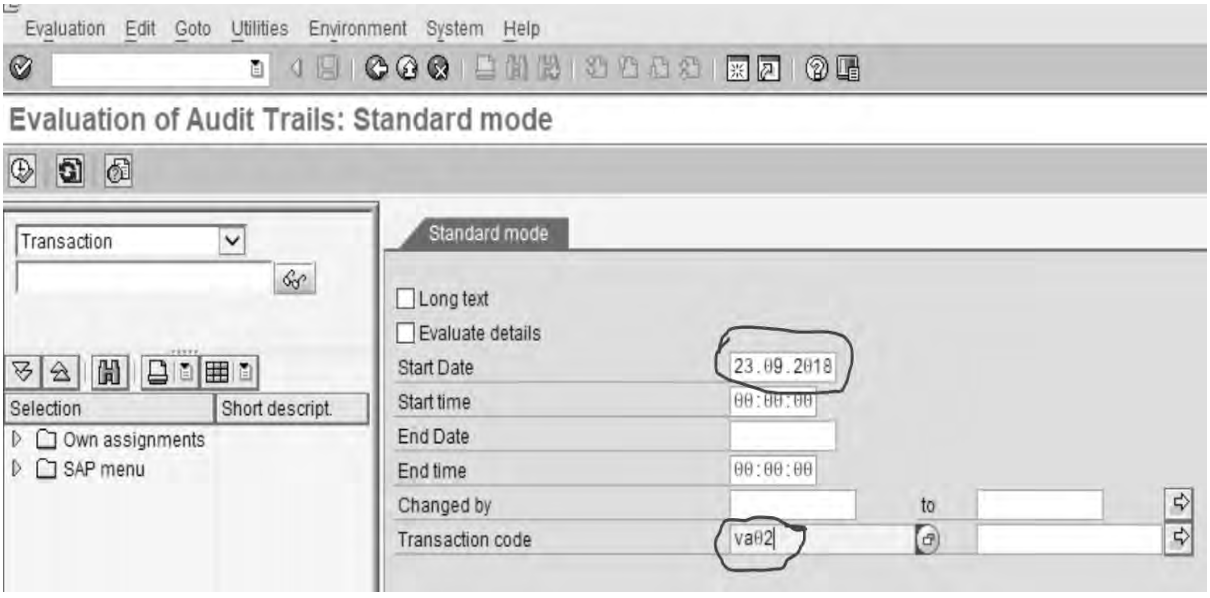
This gives all the details of the changes in the order, if we double click in any line, it will further give the details of changes, e.g if we double click at Order Quantity field, it will give the following details:



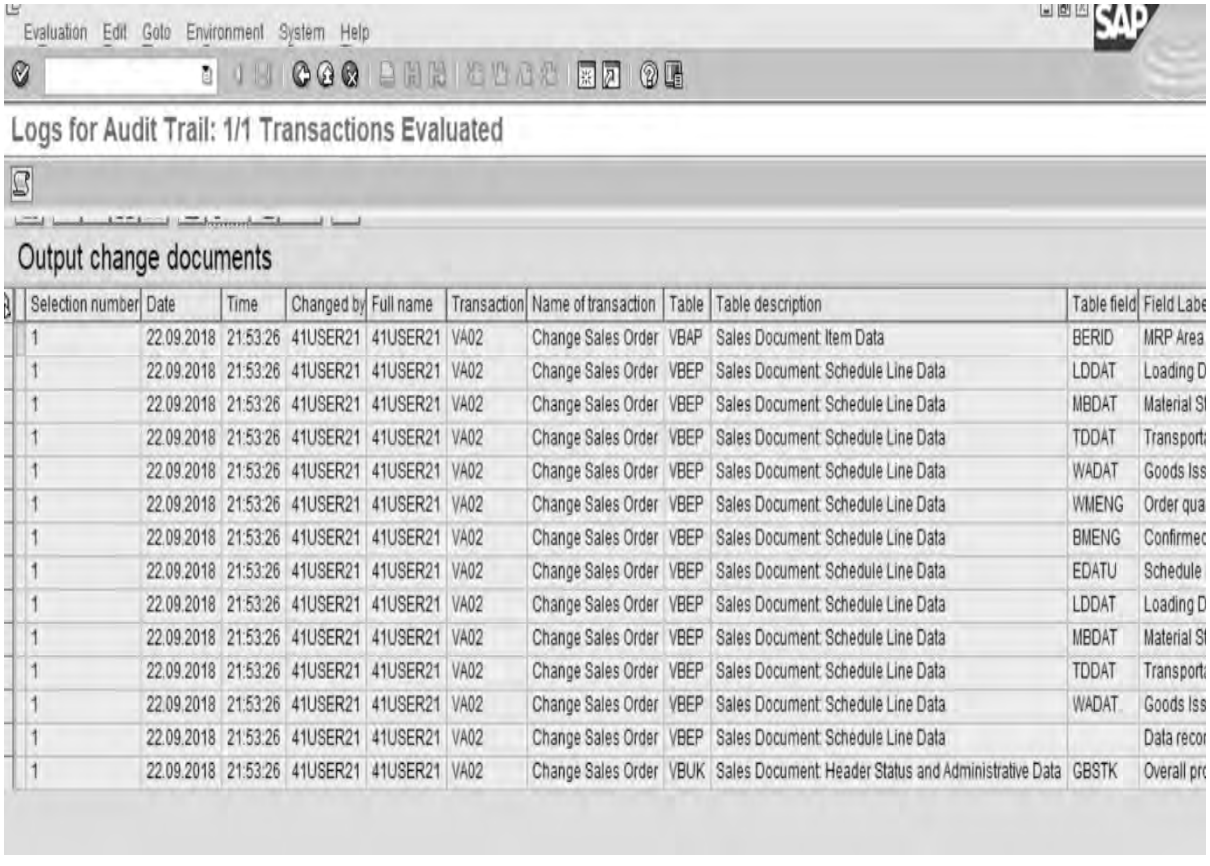
It even gives the details of previous value as well.

2. Audit Trail is the transaction to see all the amendments, if we don't have the specific document.

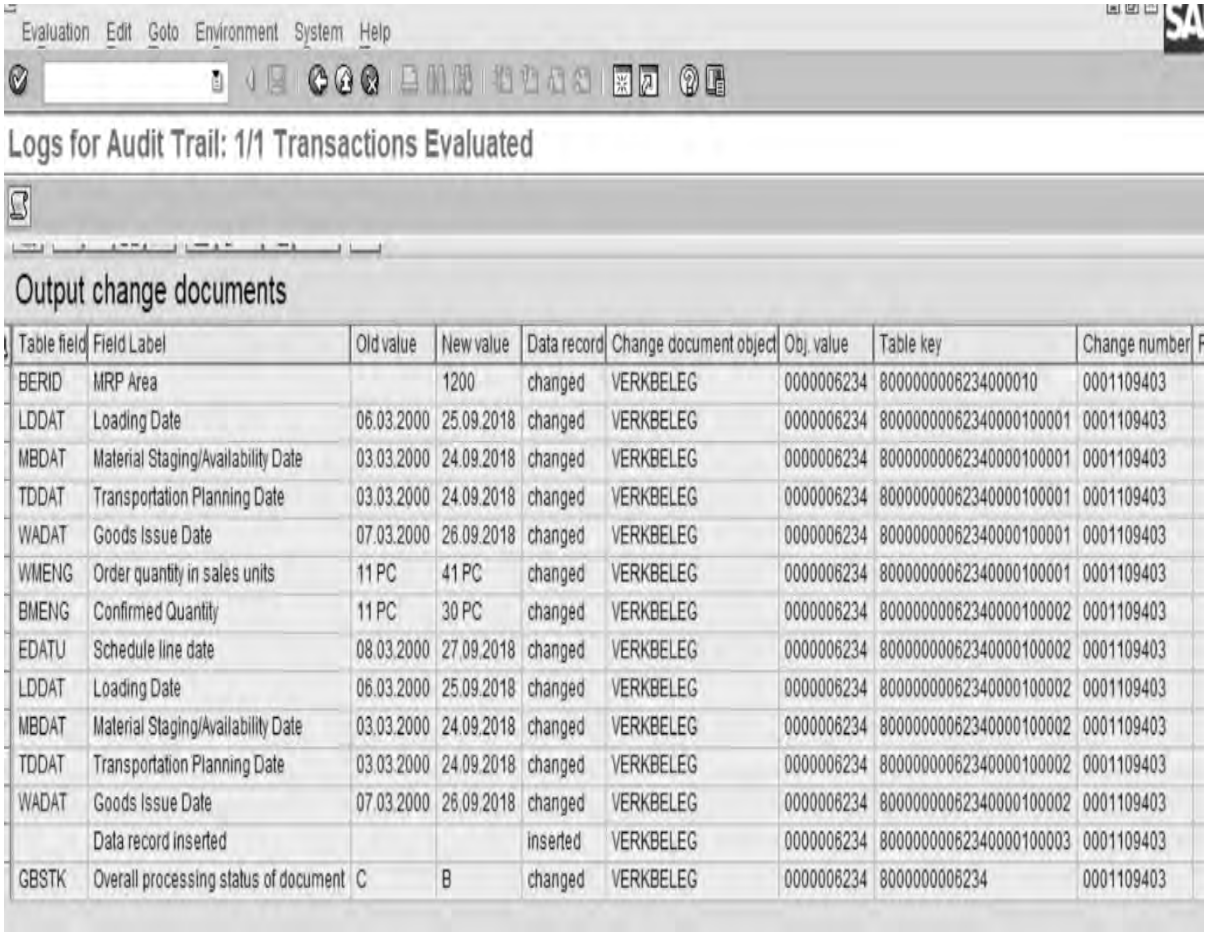
Transaction Code–AUT10 (Complete Audit Trail for any amendment)



We need at least 2 parameters to run AUT10 i.e. Date and Changes Done in any document, example here is changes in Sales Order. Click at execute button.



Selection number	Date	Time	Changed by	Full name	Transaction	Name of transaction	Table	Table description	Table field	Field Labe
1	22.09.2018	21:53:26	41USER21	41USER21	VA02	Change Sales Order	VBAP	Sales Document: Item Data	BERID	MRP Area
1	22.09.2018	21:53:26	41USER21	41USER21	VA02	Change Sales Order	VBEP	Sales Document: Schedule Line Data	LDDAT	Loading D
1	22.09.2018	21:53:26	41USER21	41USER21	VA02	Change Sales Order	VBEP	Sales Document: Schedule Line Data	MBDAT	Material St
1	22.09.2018	21:53:26	41USER21	41USER21	VA02	Change Sales Order	VBEP	Sales Document: Schedule Line Data	TDDAT	Transporta
1	22.09.2018	21:53:26	41USER21	41USER21	VA02	Change Sales Order	VBEP	Sales Document: Schedule Line Data	WADAT	Goods Iss
1	22.09.2018	21:53:26	41USER21	41USER21	VA02	Change Sales Order	VBEP	Sales Document: Schedule Line Data	WMENG	Order qua
1	22.09.2018	21:53:26	41USER21	41USER21	VA02	Change Sales Order	VBEP	Sales Document: Schedule Line Data	BMENG	Confirmed
1	22.09.2018	21:53:26	41USER21	41USER21	VA02	Change Sales Order	VBEP	Sales Document: Schedule Line Data	EDATU	Schedule
1	22.09.2018	21:53:26	41USER21	41USER21	VA02	Change Sales Order	VBEP	Sales Document: Schedule Line Data	LDDAT	Loading D
1	22.09.2018	21:53:26	41USER21	41USER21	VA02	Change Sales Order	VBEP	Sales Document: Schedule Line Data	MBDAT	Material St
1	22.09.2018	21:53:26	41USER21	41USER21	VA02	Change Sales Order	VBEP	Sales Document: Schedule Line Data	TDDAT	Transporta
1	22.09.2018	21:53:26	41USER21	41USER21	VA02	Change Sales Order	VBEP	Sales Document: Schedule Line Data	WADAT	Goods Iss
1	22.09.2018	21:53:26	41USER21	41USER21	VA02	Change Sales Order	VBEP	Sales Document: Schedule Line Data		Data recor
1	22.09.2018	21:53:26	41USER21	41USER21	VA02	Change Sales Order	VBUK	Sales Document: Header Status and Administrative Data	GBSTK	Overall pro


Evaluation Edit Goto Environment System Help

Logs for Audit Trail: 1/1 Transactions Evaluated

Output change documents

Table field	Field Label	Old value	New value	Data record	Change document object	Obj. value	Table key	Change number
BERID	MRP Area		1200	changed	VERKBELEG	0000006234	8000000006234000010	0001109403
LDDAT	Loading Date	06.03.2000	25.09.2018	changed	VERKBELEG	0000006234	80000000062340000100001	0001109403
MBDAT	Material Staging/Availability Date	03.03.2000	24.09.2018	changed	VERKBELEG	0000006234	80000000062340000100001	0001109403
TDDAT	Transportation Planning Date	03.03.2000	24.09.2018	changed	VERKBELEG	0000006234	80000000062340000100001	0001109403
WADAT	Goods Issue Date	07.03.2000	26.09.2018	changed	VERKBELEG	0000006234	80000000062340000100001	0001109403
WMENG	Order quantity in sales units	11 PC	41 PC	changed	VERKBELEG	0000006234	80000000062340000100001	0001109403
BMENG	Confirmed Quantity	11 PC	30 PC	changed	VERKBELEG	0000006234	80000000062340000100002	0001109403
EDATU	Schedule line date	08.03.2000	27.09.2018	changed	VERKBELEG	0000006234	80000000062340000100002	0001109403
LDDAT	Loading Date	06.03.2000	25.09.2018	changed	VERKBELEG	0000006234	80000000062340000100002	0001109403
MBDAT	Material Staging/Availability Date	03.03.2000	24.09.2018	changed	VERKBELEG	0000006234	80000000062340000100002	0001109403
TDDAT	Transportation Planning Date	03.03.2000	24.09.2018	changed	VERKBELEG	0000006234	80000000062340000100002	0001109403
WADAT	Goods Issue Date	07.03.2000	26.09.2018	changed	VERKBELEG	0000006234	80000000062340000100002	0001109403
	Data record inserted			inserted	VERKBELEG	0000006234	80000000062340000100003	0001109403
GBSTK	Overall processing status of document	C	B	changed	VERKBELEG	0000006234	8000000008234	0001109403

In the above report the old value and new value have been in display. AUT10 gives you all the detail changes again any transaction.

How to access the data from the database of SAP

We can even extract the data from database directly with the help of Table Name by T-Code SE16N. Run the T-Code SE16N and define the Table Name (Important Table Names are being listed below in Important Information Section.

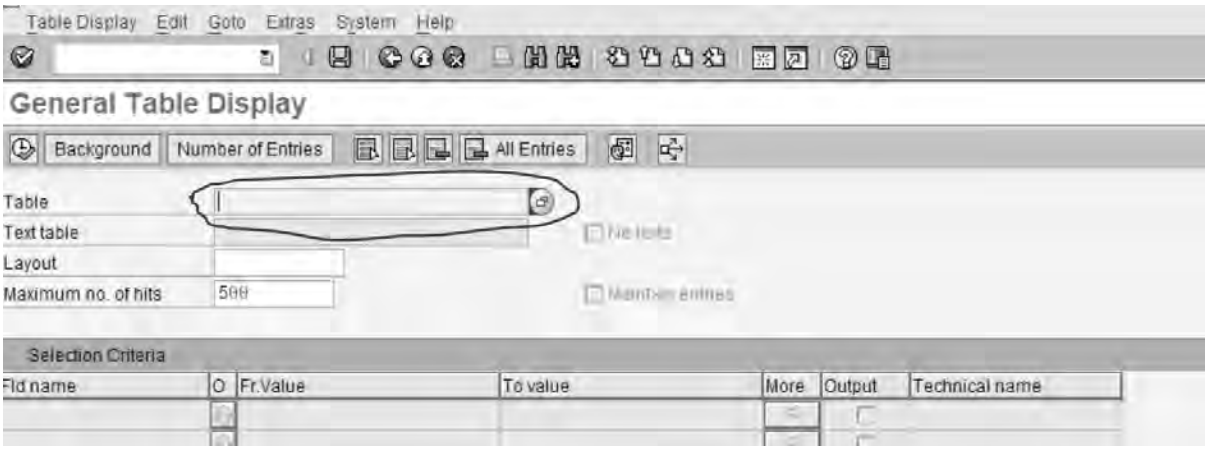


Table Display Edit Goto Extras System Help

General Table Display

Background | Number of Entries | All Entries

Table

Text table

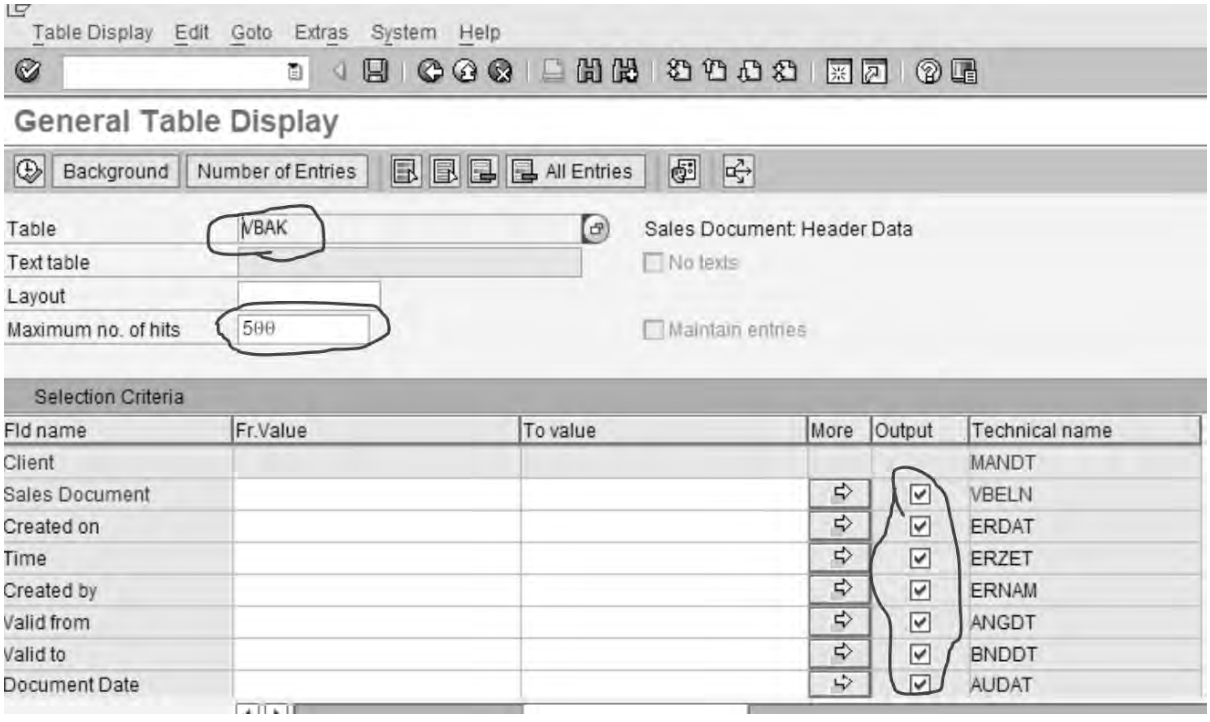
Layout

Maximum no. of hits 500

Selection Criteria

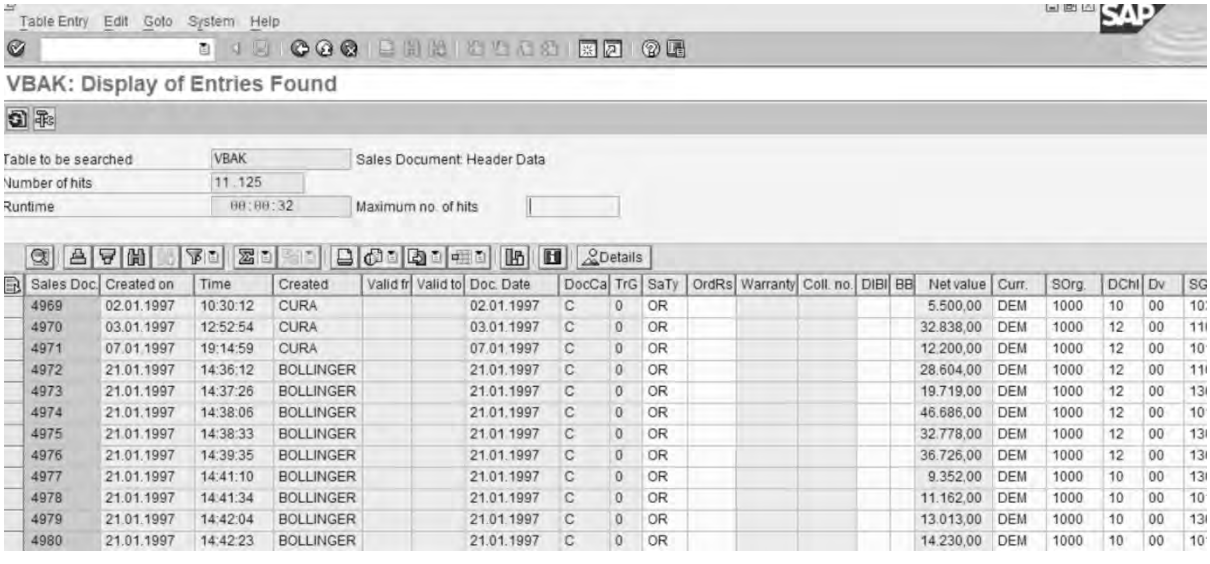
Fld name	O	Fr.Value	To value	More	Output	Technical name

For example if we want to see the extract the data of the Sales Orders, the table name is VBAK, then press enter:

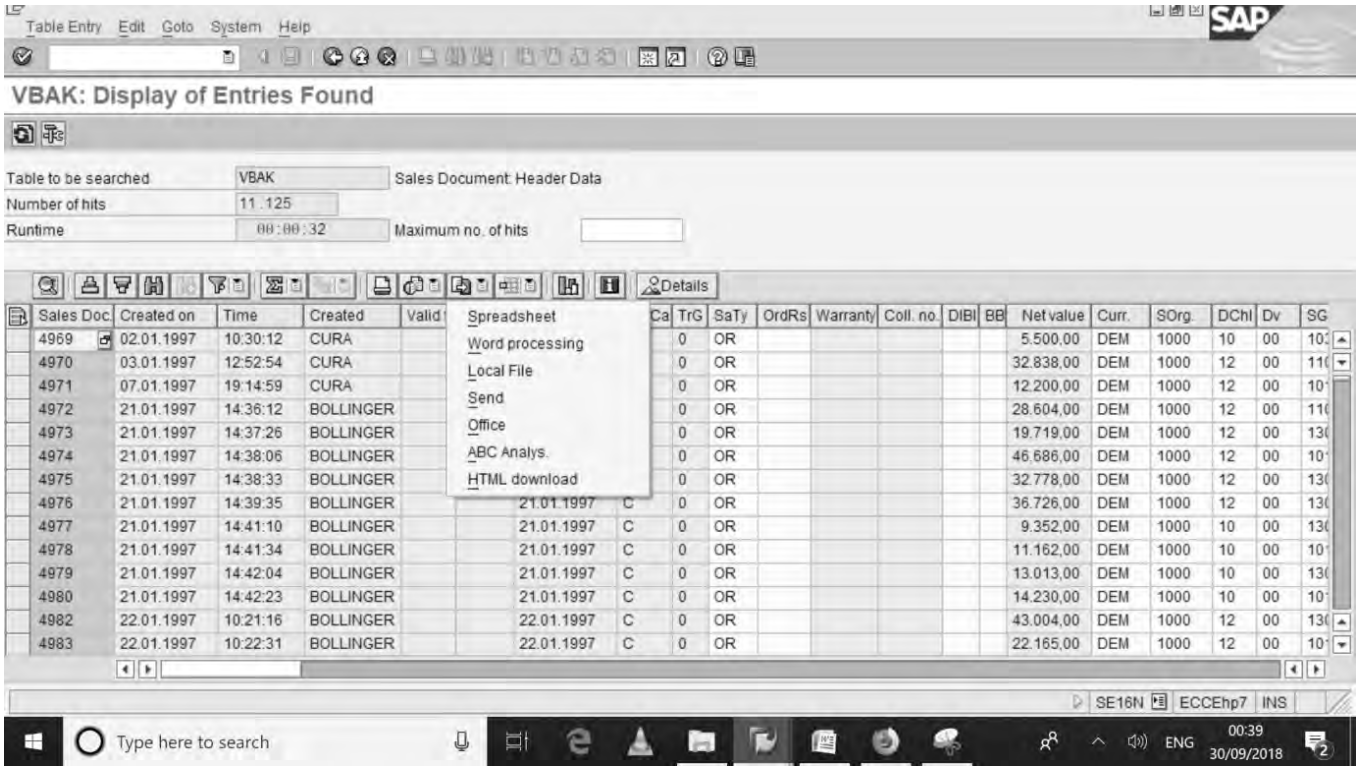


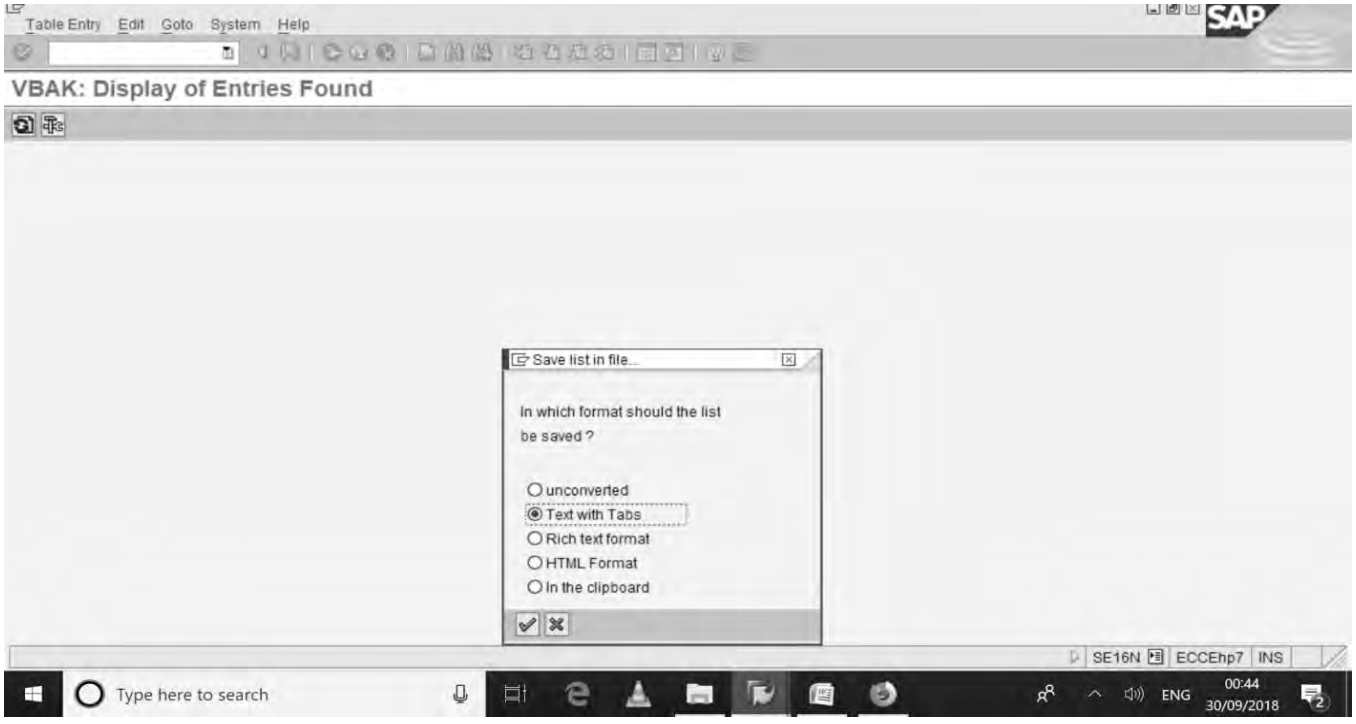
Remove the maximum number of hits 500 and make it blank to get the complete data of the Table. Select the fields relevant to us. It is recommended that we should only extract the data relevant to us. Rather than taking entire data.

Click at execute will give the entire records in that table with total no of records available:

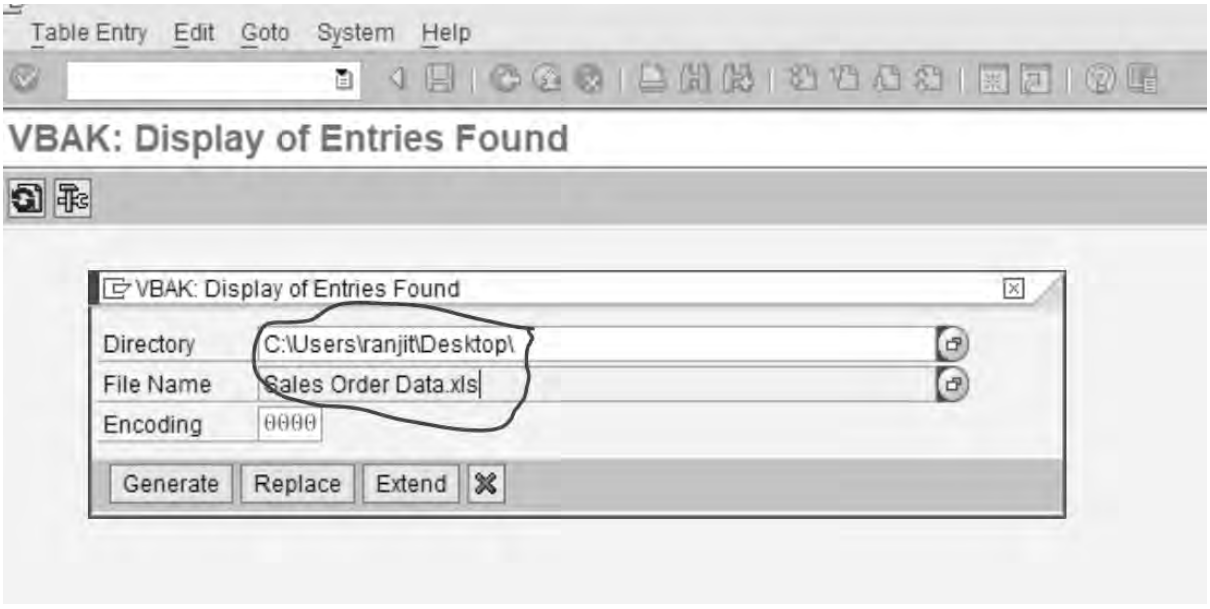


To export the data in local file or excel, click the below button, select Local File and follow the following processes:





Define the file name and location where we want to save the data and click at generate:



The above indicates that the data has been exported in Excel.

2.7.1 Important Informations

Important Tables (T-Code–SE16N)

Sales Orders		**Customer Data**	
Name	Description		
LIKP	Shipped Lines header	KNA1	Customer Master
LIPS	Shipped Lines detail	KNVV	Sales information
VBAK	Order header	KNVP	Partners (ship-to, etc)
VBAP	Table fields		
VBBE	Open sales order line items	**System tables**	
VBEP	Schedule line item	USR02	Valid user names
VBFA	Document flow		
VBUK	Order status	**Config tables**	
VBUP	Line item detail status	**T000**	**Clients**
VBRK	Billing Header	T001	Company Codes
VBRP	Billing Line Item	T001B	Permitted Posting Period
Material Management		T001W	Plants
MARA	Inventory Master	T002	Languages
MARC	Plant Data	T005	Region (Country)
MARD	Current Inventory	TCURR	Currency and exchange rates
MAKT	Descriptions	TGSB	Business Area
MBEW	Material Valuation	TVAK	Order type

Sales Orders		Customer Data	
T179	Product Hierarchy	TVSB	Shipping condition
MVKE	Sales data (materials)	TVAGT	Rejected reason for order line
MKPF	Material document		
Purchasing			
EINA	Purchasing inforecord		
EINE	Purchasing inforecord detail		
EKKO	Purchase Orders Header		
EKPO	Purchase orders items		
EKET	Scheduled lines		
EKES	Vendor confirmed lines		

Important T-Codes

Procurement–Supply Chain		Finance & Controlling	
ME23	Display Purchase Order	FBV3	Display Parked Document
FBL1	Display Vendor Line Items	FB03	Display Document
XK03	Display vendor (centrally)	KSB1	Cost Line Items
FK10	Vendor Account Balance	KE5Z	Profit Centre Actual Line Items
MK03	Display vendor (Purchasing)	FS10	Balance GL
VL03	Display Delivery	KCH3	Display profit Centre hierarchy
KO03	Display Internal Order	FBL3	Display G/L Account Line Items
FCH2	Display Payment Document Checks	KS03	Display Master Cost Centre
		FBU3	Display Intercompany Document
Sales–Order Fulfilment			
FD10	Customer Account Balance	Inventories	
FBL5	Display Customer Line Items	MB03	Display Material Document
VF03	Display Billing Document	MM03	Display Material
VA03	Sales Orders	MB51	Material Doc. List
VA05	List of Sales Orders	CKMB	Display Material Ledger Document
VF05	List of Billing Documents	MD04	Display Stock/ Requirements Situation
KSB1	Cost Line Items for CoCe	MC.9	Material Analysis/ Stock
VD03	Display Customer (Sales)	MMBE	Stock Overview
VT03N	Display Shipment		
ME2L	Purchase Orders by Vendor	System	
ME2M	Purchase Orders by Material	VL03N	Display Outbound Delivery
		SP01	Spool Request

Procurement–Supply Chain		**Finance & Controlling**	
Asset Management		SP02	Spool - Output Device LOCL Wide Report
IE03	Display Equipment	SE16	Data Browser
MI03	Display Physical Inventory Document		
AS03	Display Asset Master Record		
AR01	Call Asset List		
IH10	Display Equipment		

Important T-codes for Report

Report Area	**Reports Name**	**Description**
Controlling	S_ALR_87013611	Cost Centre accounting - Plan/ Actual comparison
Controlling	S_ALR_87013640	Cost Centre accounting - Actual/ Actual comparison
Controlling	KSBL	Cost Centre plan
Controlling	S_P99_41000111	Analyse/ compare product cost estmates
Controlling	KE30	Profitability report
Controlling	S_ALR_87010777	Profit Centre report
Finance	S_ALR_8701249/ 87012250/ 87012251/ 87012252	Actual comparison of financial results by period with previous period
Finance	S_ALR_870122284	Balance Sheet/ P&L statement
Finance	S_ALR_87012253	Plan/ actual comparison on periodic basis
Finance	S_ALR_87012271	Cash flow report
Finance	S_ALR_87012277	GL Balances
Finance	S_ALR_87012287	Document Journal at summary level
Finance	S_ALR_87012332	Statement of customer/ vendor/ GL Accounts
Finance	S_ALR_87012177	Customer payment history
Finance	S_ALR_87012168	Due date analysis for customer open items
Finance	S_ALR_87012167	Account receivable information system
Finance	S_ALR_87012172	Customer balances
Finance	S_ALR_87012176	Customer evaluation with open item sorted list
Finance	S_ALR_87012077	Vendor information system
Finance	S_ALR_87012093	Vendor business
Finance	S_ALR_87012078	Due date analysis for supplier open items
Finance	S_ALR_87012085	Vendor payment history
Finance	S_P99_41000101	Check register
Finance	S_ALR_87012075	Asset History
Finance	S_ALR_87012936	Depreciation simulation/ forecast
Finance	S_P99_41000192	Posted depreciation
Finance	J1IQ	Year end income-tax depreciation report
Finance	S_ALR_87011981	Asset Inventory list

Report Area	Reports Name	Description
Finance	S_ALR_87012291	Document Journal at line item level
Inventory	MB51	Material document listing
Inventory	MR51	Account document listing
Inventory	MMBE	Stock Overview
Inventory	MD04	Stock requirement list
Inventory	MB52	Plant Stock availability
Inventory	MB5M	Expiration date list
Inventory	MB5B	Stock on posting date
Inventory	MB5T	Stock in transit
Inventory	MBLB	Stock with subcontractor
Inventory	MB5S	List of GR/ IR balances
Inventory	MCBG	MRP Controller analysis
Inventory	MC40	Material usage based ABC Analysis
Inventory	MC42	Range of coverage
Inventory	MC44	Inventory turnover
Inventory	MC46	Slow moving items
Inventory	MC50	Dead Stock items
Inventory	MC45	Usage value
Inventory	CO09	Availability overview
Inventory	MI24	Physical inventory listing
Logistics	MM60	Commodity listing
Logistics	MC$G	Purchase value
Logistics	S_ALR_87012972	Batch where used list
Logistics	S_ALR_87012975	Engineering change management
Logistics	SAP1	All Standard SAP Reports -- Module wise
Maintenance	IH08	Display machine list
Maintenance	MCJB	MTTR/ MTBR for machine
Maintenance	MCI5	Damage analysis
Maintenance	MCI7	Breakdown analysis
Maintenance	MCI8	Maintenance cost analysis
Maintenance	MCIA	Customer notification analysis
Production	CS03	Bill of Materials
Production	CR60	Work Centre information system
Production	MCPB	Work cener analysis
Production	MCPW	Material analysis
Production	MCP1	Operation analysis
Production	MCRP	In repetitive manufacturing setup:
Production	MF60	Pull list
Production	MCP5	For process industry:
Production	MCQ.	Kanban analysis
Production	PK13	Kanban analysis

Report Area	Reports Name	Description
Production	MCRE	Material usage analysis
Production	MCRI	Product cost analysis
Production	KKBC_HOE	Product cost analysis - Summarised
Production	S_ALR_8701348	Cost Variance Target/ Actual
Production	CO46	Order progress report
Production	COOIS	Production order information system
Production	KKBC_Ord	Production order cost analysis
Production	MCPY	Operation analysis
Production	MCP3	Material analysis
Production	MCP5	Work Centre analysis
Production	MCPB	Production order analysis
Production	MCRK	Production analysis
Production	MCP6	Material consumption analysis
Production	MCRU	Shop floor information system related to material analysis,
Production	MCRV	operation analysis, process order analysis, material usage analysis, product cost analysis
Production	CO24	Missing parts checklist
Project System	S_ALR_87013531	Project cost/ revenue/ expenditure
Purchase	ME80FN	Purhase order analysis
Purchase	ME2L	Purchase order display
Purchase	ME81N	Anlysis of order values
Purchase	ME2V	Goods receipt forecast
Purchase	ME2O	Stock lying with subcontractors
Purchase	ME2A	Monitor supplier confirmation
Purchase	MCE1	Purchase analysis
Purchase	MCEA	Long term planning analysis
Purchase	MKVZ	Vendoe master list
Purchase	ME5A	Status of indents
Purchase	ME4L	Quotations listing
Purchase	ME1L	Commodity price
Purchase	MEQM	Planned share of business
Purchase	ME64	Vendor rating
Quality Magt	QGP1	History of inspection characteristics
Quality Magt	QGC1	Control Chart
Quality Magt	QM11	Quality Notification analysis
Quality Magt	MCXX	Defect analysis report
Quality Magt	IP24	Calliberation inspection
Sales	MCTA	Sales analysis
Sales	MC(A	Sales analysis by Material
Sales	MC+2	Sale report with option like

Report Area	Reports Name	Description
Sales & Distribution	VA15N	Inquiries List
Sales & Distribution	VA25N	Quotations List
Sales & Distribution	SDQ1	Expiring Quotations
Sales & Distribution	SDQ2	Expired Quotations
Sales & Distribution	SDQ3	Completed Quotations
Sales & Distribution	VA05N	List of Sales Orders
Sales & Distribution	SDO1	Orders Within Time Period
Sales & Distribution	V.02	Incomplete Orders
Sales & Distribution	VA35N	List of Scheduling Agreements
Sales & Distribution	VA45N	List of Contracts
Sales & Distribution	SDV1	Expiring Contracts
Sales & Distribution	SDV2	Expired Contracts
Sales & Distribution	SDV3	Completed Contracts
Sales & Distribution	VA14L	Sales Documents Blocked for Delivery
Sales & Distribution	V.23	Sales Documents Blocked for Billing
Sales & Distribution	VL06O	Outbound Delivery Monitor
Sales & Distribution	VF05N	List of Billing Documents
Sales & Distribution	VB(8	List Rebate Agreements
Sales & Distribution	S_ALR_87012218	Credit master sheet
Sales & Distribution	F.31	Credit Management Overview
Sales & Distribution	FCV3	Credit Management Early warning list
Sales & Distribution	MCTA	SIS: Customer Analysis
Sales & Distribution	MCTC	SIS: Material Analysis
Sales & Distribution	MCTE	SIS: Sales organisation
Sales & Distribution	MCTK	SIS: Shipping point
Sales & Distribution	MCTI	SIS: Sales employee
Sales & Distribution	MCTG	SIS: Sales office
Sales & Distribution	MC(A	SIS: Incoming orders
Sales & Distribution	MC+A	SIS: Returns
Sales & Distribution	MC+E	SIS: Customer Analysis: Invoiced Sales
Sales & Distribution	MC+I	SIS: Customer Analysis: Credit memos
Sales & Distribution	F.35	SIS: Credit master sheet
Sales & Distribution	MC(E	SIS: Material Analysis: Incoming orders
Sales & Distribution	MC+M	SIS: Material Analysis: Returns
Sales & Distribution	MC+Q	SIS: Material Analysis: Invoiced Sales
Sales & Distribution	MC+U	SIS: Material Analysis: Credit memos
Sales & Distribution	MC(I	SIS: Sales Organisation Analysis: Incoming orders
Sales & Distribution	MC+Y	SIS: Sales Organisation Analysis: Returns
Sales & Distribution	MC+2	SIS: Sales Organisation Analysis: Sales
Sales & Distribution	MC+6	SIS: Sales Organisation Analysis: Credit memos
Sales & Distribution	MC(M	SIS: Sales Office Analysis: Incoming orders

Report Area	Reports Name	Description
Sales & Distribution	MC-A	SIS: Sales Office Analysis: Returns
Sales & Distribution	MC-E	SIS: Sales Office Analysis: Sales
Sales & Distribution	MC-I	SIS: Sales Office Analysis: Credit memos
Sales & Distribution	MC(Q	SIS: Sales Employee Analysis: Incoming orders
Sales & Distribution	MC-M	SIS: Sales Employee Analysis: Returns
Sales & Distribution	MC-Q	SIS: Sales Employee Analysis: Sales
Sales & Distribution	MC-U	SIS: Sales Employee Analysis: Credit memos
Sales & Distribution	VC/ 2	Sales Summary (Customer Fact Sheet)
Sales & Distribution	V/ LD	Pricing Reports
Sales & Distribution	VD59	List Customer Material Info
Sales & Distribution	VB35	Promotion List
Sales & Distribution	VB25	List of Sales Deals
Sales & Distribution	VC05	List of Sales Activities
Sales & Distribution	VB25	List of Sales Deals
Sales & Distribution	VCUST	Customer List
Sales & Distribution	MC+A	Incoming orders
Sales & Distribution	MC+E	Invoiced sales
Sales & Distribution	MC+I	Credit Memo
Sales & Distribution	MC+U	Sales return
Sales & Distribution	MC+6	Area wise
Sales & Distribution	MCSI	State-wise

3. TECHNIQUES OF INVESTIGATION OF ACCOUNTS

Manipulation of books of accounts is a common phenomenon to evade income-taxes. Generally speaking, income is concealed by resorting to following methods:

In the Books of Accounts

- Bogus purchases/ expenses
- Inflated purchases/ expenses
- Suppressed sales/ receipts
- Suppression of production
- Understatement of stock
- Artificial loss.
- Diversion/ division of income
- Giving the receipt a non-taxable character.

Outside the Books of Accounts

- Unaccounted business transactions.
- Unaccounted investment

3.1 Manifestation of Concealed Income/ Unaccounted Funds

- Cash credit
- Bogus sales/ receipts
- Financing purchase of assets
- Financing secret/ personal expenses
- Remittance/ Gifts
- Introduction of cash at shortage time

As far as the transactions which are totally outside the books of accounts are concerned, they can be unearthed through direct actions such as Survey, Search and Seizure etc. Income concealed through recorded entries can however be detected through investigation of accounts. Such investigation, therefore, assumes great significance.

The investigator is required to possess certain qualities in order to achieve the best results. These qualities are:

1. Knowledge of accountancy: It is necessary that the investigator should have knowledge of Double entry book-keeping as well as the Indian system.
2. Knowledge of trade: In case, investigating officer does not have knowledge of a particular trade, he can acquire the same from his peers/ colleagues or even from the experts in the field.
3. Experience: In case, the investigating officer has no experience, he can draw the experience of his peers/ colleagues.
4. Diligence and tenacity: The investigator has to make persistent efforts and he should be tenacious in the face of reverses and disappointments and refuses to be side tracked from a promising lead.
5. Intuition and an eye for unusual: Locating something unusual often leads to detection of concealment.

3.2 Selecting the Case for Scrutiny and Identifying the Area of Investigation

As per the provisions of income-tax Act, the assessee, who is maintaining regular books of accounts has to enclose copies of the Manufacturing Account, Trading Account, Profit & Loss Account, Balance Sheet and Audit Report to the return of income, wherever accounts are audited. A study of these statements is the first step in the process of identifying the areas of investigation.

Ratio analysis is an effective tool for the purpose of identifying the areas of investigation. The term 'Ratio' refers to the numerical or quantitative relationship between two items/ variables. A number of ratios are used for financial management. Different types of ratios can be used by the Investigators to identify the area of investigation. These ratios are discussed below:

3.2.1 The Ratio of Current Tax as Against the Net Profit before Taxation (PBT)

This ratio is important because in general the current tax against PBT may range from 20% to 30%. If it goes below the rate specified u/s 115 JB then the assesee would be made liable to pay the difference in the form of MAT.

Step 1

The investigator can export the details of all the assesee from the ITBA software to an excel file. Once the data is in excel format then by using the formula (Current Tax/ Profit before Tax) a ratio of the two figures can be worked out. The formula can be copied for all the assessees.

Step 2

After applying the formula the data can be arranged in ascending order (using Sort Data function in excel). With this we get the name of the assessee who has paid the lowest tax as against the profits earned.

Step 3

Select the assessee with high profits and low tax ratio. Copy the top 20 cases (or any number as required) with the lowest ratio to a different excel sheet and rearrange it in descending order but this time on the basis of total profits.

Step 4

Then do a detail scrutiny of the computation of income filed by the assessee to understand the reasons behind the difference between the Net profit as per Profit & Loss account and the taxable profit as per computation.

3.3 Major Reasons of Deviations

1. Depreciation as per income-tax may be higher than the depreciation computed as per accounting standards.
2. Assessee may be having large income, which is exempt from taxation
3. There might be standard deductions (like 30% in case of house property income)
4. Capital gain from sale of fixed asset.

Depending upon the reasons of deviations the Investigator can decide the further course of action.

There are a number of ratios that are generally used for financial management. Nine different types of ratios can be used by the investigators to identify the area of investigation. These ratios are discussed below:

1. Acid Test or Quick Ratio:

$$\text{Acid Test Ratio} = \frac{\text{Quick Assets}}{\text{Current Liabilities}}$$

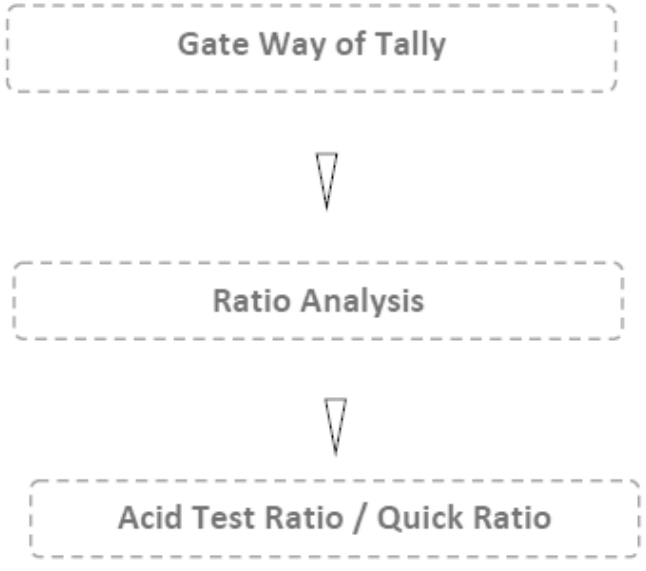
Quick Assets = Cash/ Bank balance + Short term securities + Sundry Debtors + Bills Receivable etc.

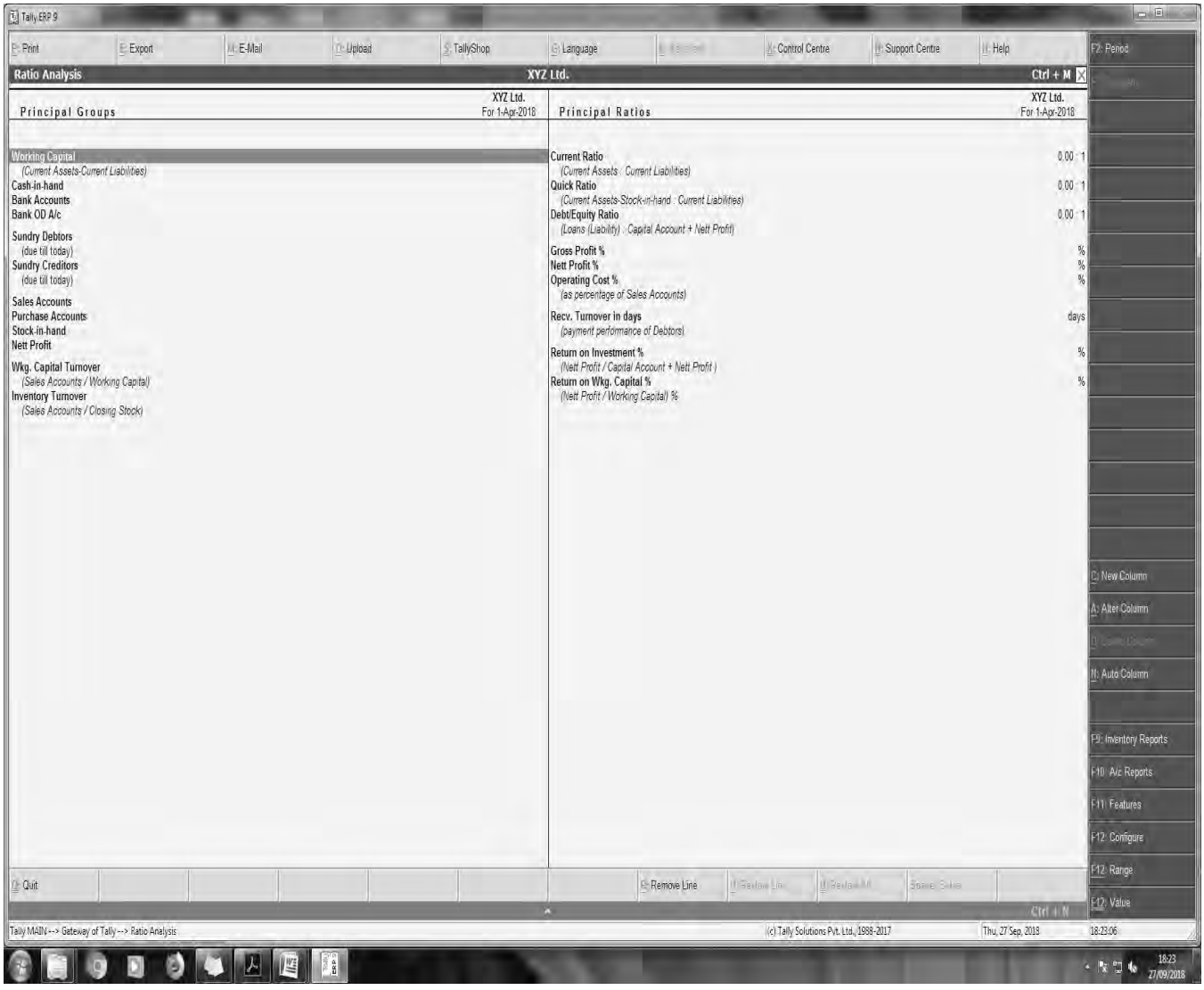
Current Liabilities = Trade Creditors + Bills Payable + Bank Credit + Provisions for taxation + Dividends Payable + Outstanding Expenses

It measures the ability of an entity to use its quick or current assets to extinguish or retire its current liabilities immediately by converting them into cash immediately or at a short notice, without diminution of their value.

An acid test ratio of 1 is considered satisfactory as the businessman can meet all its current claims. If it is less than 1 say 0.5 and remains around that level for a few years without default in payment of the current liabilities, then unless the industry average is similar (e.g. seasonal industries), most likely, the firm is using its own secret funds in the form of cash credit during the year, which is withdrawn before the end of the year. The area of investigation in such case will be the squared up cash credit accounts.

This Ratio can be viewed easily in Tally Software through following steps.





(Tally screen–showing various ratios on the right hand side)

2. Stock Turnover Ratio:

$$\text{Stock turnover ratio} = \frac{\text{Cost of goods sold}}{\text{Average Stock}}$$

$$\text{Cost of goods sold} = \text{Sales - Gross Profit}$$

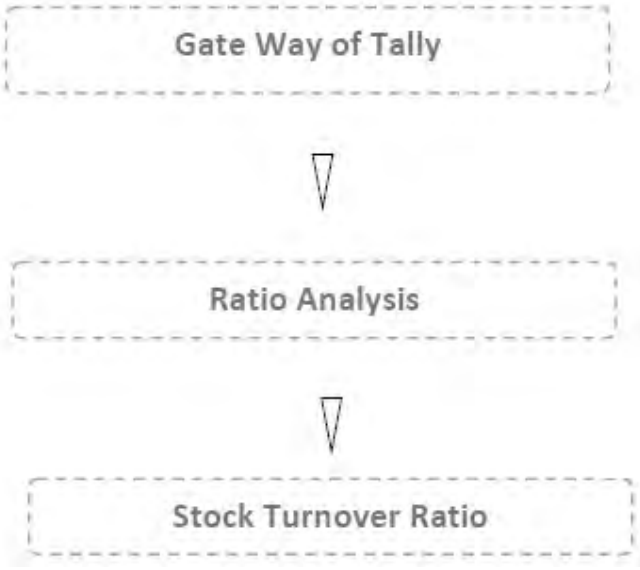
$$\text{Average Stock} = \frac{\text{Opening Stock} + \text{Closing Stock}}{2}$$

The ratio indicates how fast the inventory is sold. A high ratio is good from the point of view of liquidity and vice-versa.

Over a period of time, the ratio generally remains stable year after year in the case of a particular assessee, unless there is a change in the nature of business. Wide fluctuations suggest manipulation of stock. A sudden increase in the ratio in the year indicates the possibility of understatement of closing stock. If the ratio is more than 10 or more than that in the past years, then besides unaccounted stock, there is also a possibility of bogus or inflated purchases. In such cases, the Assessing Officer should concentrate more on purchase and stock.

If the ratio is below normal, it indicated possibility of unaccounted sales or hawala sales. If the ratio is below normal but the gross profit and net profit are normal, then in such cases, the Investigator should verify whether the assessee has borrowed heavy loans quite disproportionate to his own capital and if so, the investigator should verify the genuineness of these loans. In most of the cases of low ratio, a physical verification of stock will reveal that the stock physically available with the assessee is much less than the stock as per the books of accounts.

The Ratio can be viewed in Tally Software through following steps.



3. Debtor's Turnover Ratio:

$$\text{Debtor's turnover ratio} = \frac{\text{Net Credit Sales}}{\text{Average Trade Debtors}}$$

$$\text{Average Trade Debtors} = \frac{\text{Opening Debtors} + \text{Closing Debtors}}{2}$$

A high ratio indicates shorter debt collection period and low ratio indicates longer debt collection period. A sudden increase in debt collection period indicates that the assessee may be realising the debtors but not showing the realisation in the books of accounts. This may particularly be true in the case of traders. An independent verification of the accounts of the debtors in such cases may yield result.

The Ratio can be viewed in Tally Software through following steps.

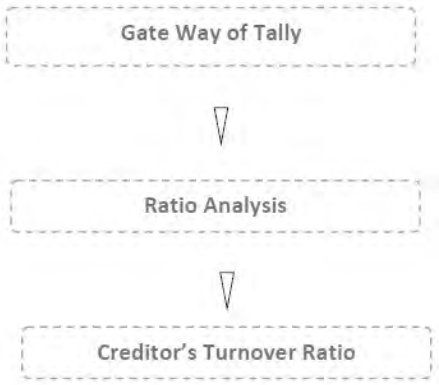
4. Creditor's Turnover Ratio:

$$\text{Creditor's turnover ratio} = \frac{\text{Net Credit Purchases}}{\text{Average Creditors}}$$

$$\text{Average Creditors} = \frac{\text{Opening Creditors} + \text{Closing Creditors}}{2}$$

A low ratio indicates liberal credit terms allowed by suppliers, while a high ratio shows that the accounts are being settled rapidly. A low ratio indicates possibility of inflation of purchases requiring scrutiny of the credit purchases, especially during the last two months of the financial years.

The Ratio can be viewed in Tally Software through following steps

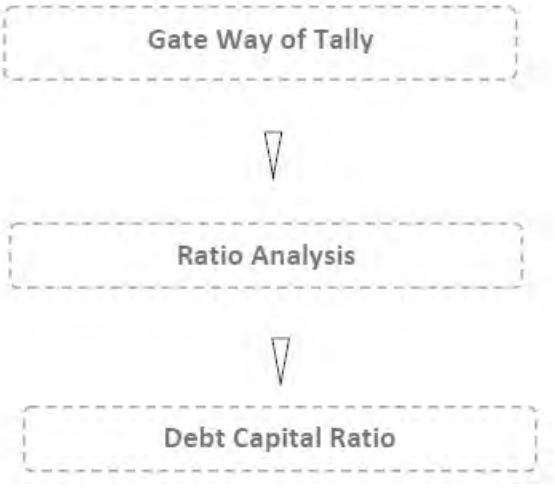


5. Debt Capital Ratio:

$$\text{Debt Capital Ratio} = \frac{\text{Long Term Debt}}{\text{Capital contributed by owners}}$$

The capital contributed by owners includes capital introduced by proprietor or partners or shareholders equity in a company. This ratio is normally 2. A high ratio (unless there are heavy losses or other satisfactory reasons) indicates possibility of borrowed funds being utilised for non-business purpose including purchase of non-business assets. The utilization of borrowed funds would need to be critically examined for possible disallowance of interest on the funds Utilised for non-business purposes.

The Ratio can be viewed in Tally Software through following steps.



6. Gross Profit Ratio:

$$\text{Gross Profit Ratio} = \frac{\text{Gross Profit x 100}}{\text{Sales}}$$

This ratio is frequently used for financial investigation in the income-tax Department. Gross profit is a result of the interaction between sales price and cost price. The ratio is usually known by comparison with the past record of the assessee and/ or other assessee engaged in the same line of business. A relatively low ratio is definitely a signal for thorough investigation for the possible understatement of income. In computing the gross profit ratio, only those items of prime cost should be included, which vary directly with the sales and have direct bearing on the trading operations only. If any trading account or manufacturing account is found to deviate from this principal, the ratio should be recomputed after excluding the following:

a. Capital receipts or expenditure and receipt of casual and non-recurring nature

b. Speculative profits or losses or profits and losses of other business

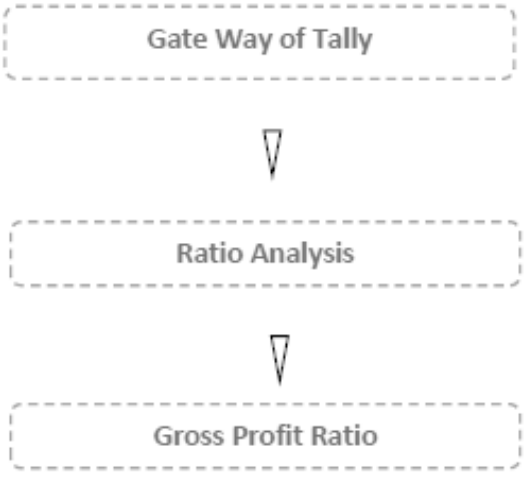
c. Any expenses which are not to be included in the prime cost such as interest, advertisement expenses etc..

However, the on account of prime cost such as freight inward, customs day, loading and clearing expenses, toll charges and cartage expenses for goods purchased needs to be included.

The important point for examining the gross profit ratio is that the comparison should be on the principle of "like to like". To illustrate this point, it may be mentioned that the case of an assessee with modest turnover cannot be compared with the assessee with huge turnover.

It should however, be remembered that low gross profit or fall in gross profit is only the starting point of enquiry and not an end in itself. The general explanations like competition, wastage, pilferage etc. should not be accepted but the assessee should be asked to substantiate and quantify their impact on the gross profit rate. For example, the effect of competition can be ascertained by finding out the prices currently charged by the assessee in comparison to others in the similar trade. In suitable cases, the assessee may be asked to sort out purchases and sales in term of quantity and value and work out the average purchase rate and sales for a specified period, say a few weeks. The Investigator can then analyse the reasons and see if there is inflation of purchase or understatement of sales.

This Ratio can be viewed in Tally Software through following steps.



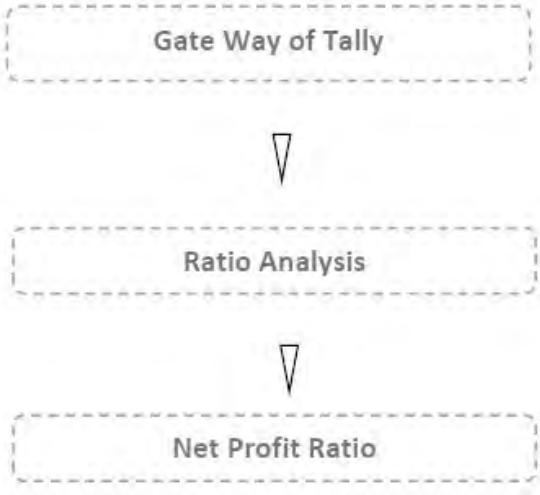
7. Net Profit Ratio:

$$\text{Net Profit Ratio} = \frac{\text{Net Operative Profit X 100}}{\text{Sales}}$$

Net Operative Profit = Net Profit + Interest + Depreciation + Partner's/ Director's remuneration

This ratio indicates the managements' ability to operate the business with sufficient success to meet all the expenses and still leave a margin of reasonable compensation including remuneration to the owners for their capital contribution. This ratio should be carefully scrutinized for possible inflation of indirect expenses. Sometimes the gross profit ratio is artificially inflated to escape scrutiny, but net profit is reduced because the net profit to sales ratio is generally not compared with the preceding years' ratio.

The Ratio can be viewed in Tally Software through following steps.



8. Expenses Ratio:

Expenses ratio is useful in indicating the lines of investigation particularly in manufacturing concerns. Expenses ratio is divided in three sub-categories:

a. Yield ratio or cost ratio.

b. Factory wages to cost of goods manufactured.

c. Cost and quantity of fuel or electricity consumed to cost and quantity of goods manufactured.

Quite often, production, is suppressed while the manufacturing expenses are fully accounted for. The examination of expenses ratio would indicate the areas requiring further investigation with a view to detect suppression of production or inflation of manufacturing expenses.

This ratio cannot be viewed directly in Tally in the present version. However, this ratio could be obtained manually.

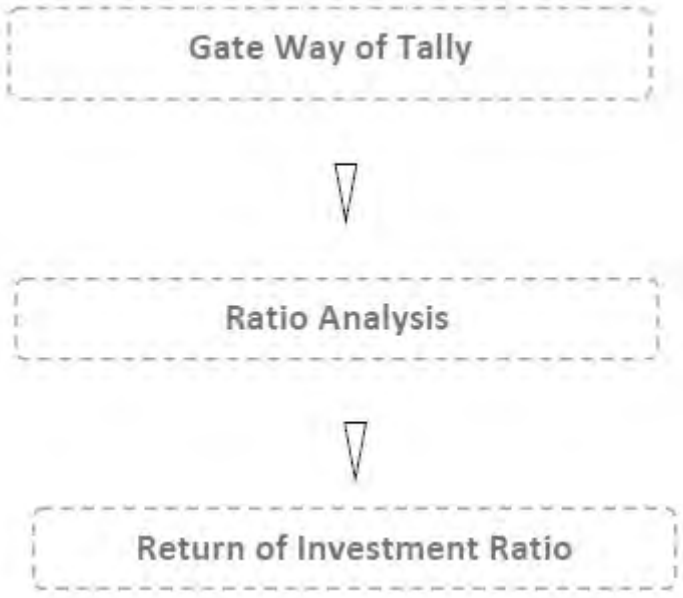
9. Return on Investment Ratio:

$$\text{Return of investment ratio} = \frac{\text{Profit}}{\text{Capital Employed}}$$

Any prudent businessman will invest in business only if the return on investment is more than the interest offered on bank fixed deposits. The fall in the ratio will indicate concealment of income by way of inflation of purchases/ expenses or suppression of sales and understatement of stock.

The study of ratio analysis has its own limitations. It should be used with great care. The Investigator should remember that ratio analysis is only a mean to an end and not an end in itself. It helps the investigator in planning the investigation by indicating areas where the possibility of detecting concealment is high.

The Ratio can be viewed in Tally Software through following steps.



3.3.1 Funds Flow Statement

"Funds" for a "funds flow statement" means resources which cause all external transactions of a business entity. Such transactions might involve exchange of cash or credit or any other asset. Funds flows can change their form with every transaction. Each transaction results in some change in assets and/ or liabilities.

For preparing a funds flow statement, the liabilities side of a balance-Sheet is treated as the financing side, reflecting sources of funds, and the assets side as the investment side, reflecting uses of funds. When some liabilities are repaid, uses of funds are involved; similarly, when some disinvestments take place, it becomes a source of funds. Changes in assets and liabilities over any period can thus be identified, to prepare a funds flow statement.

3.3.2 Uses of Funds Flow Statement

Firstly, it enables to clearly identify the amount of funds generated or lost in operations, and how the funds generated have been utilised for - taxes, dividends and amount retained in the business?

Secondly, aside from retained earnings which become a part of long-term funds, from where have other long-term funds been secured and what is the extent of use of these funds, for long term purposes? This tells as to what happens to net working capital, which is long term funds' contribution towards acquisition of current assets and which affects current ratio.

Thirdly, specific movements in major items of long-term funds, long-term assets, current assets and current liabilities become apparent. By concentrating on them, major shifts in resources and their financing can be highlighted.

3.3.3 Cash Flow Statement

The cash flows are the inflows and outflows of cash of a concern. A cash flow statement is a statement of cash flows during the period to which it pertains. Cash flow statements are prepared on historical as well as projected basis. Prepared on projected basis, it becomes a cash budget.

It projects cash inflows and cash outflows for an ensuing period, usually divided into sub-periods, to bring out the likely cash position at various intervals. On the basis of these projections, a business could plan additional sources of cash including bank borrowings to fill projected short-falls as also investment of projected surpluses.

A cash flow statement on historical basis is simply a summary of the cash book of a business, all items being classified into broad heads. It thus shows sources and uses of cash during a given period. Cash inflows of a business are its most significant events upon which accounting measurements are based and upon which, investors and creditors base their decisions. For the management, the projected cash flow statement is an instrument of liquidity management, while a historical cash flow statement provides the basis for reviewing the performance.

3.3.4 Uses of Cash Flow Statement

Cash Flow statements become significant in following situations:

a. For highly seasonal industrial and trading units, working capital needs fluctuate fast and cannot be estimated on a yearly basis. A yearly cash credit limit may not thus serve the purpose.

b. For weak and sick units, close monitoring of cash receipts and payments, sometimes even on a day-to-day basis, is called for. The purpose is served by looking at cash flow statements prepared on a required interval basis.

c. In cases where diversion or misuse of funds is suspected, it might be useful to examine frequent cash flow statements.

3.4 Examination of Accounts

The following points should be examined, while conducting a preliminary examination of the books of accounts:

1. Are the accounts maintained as per the notified accounting standards?
2. Is there any unusual or uncommon feature in the books of accounts?
3. Are the account books written in sufficient detail to facilitate the ascertaining the nature and character of the transactions?
4. Are subsidiary books maintained by the assessee and are they maintained in sufficient details?
5. Are the documents and vouchers to support the entries in the books of accounts available and if available, are they reliable?
6. Has the income of the year been postponed by the assessee by credit to suspense account, creditors account or otherwise totally omitted from the accounts of the year under considration?
7. Does the Auditor's Report or Notes on Accounts refer to any issue which affects the taxable income of the year?
8. What is the scope of the audit? Has the auditor submitted separate report to the owners of the business and, if so, does it contain any reference to the correctness and completeness of the accounts?
9. Had any other type of audit, such as cost audit, financial audit, special audit, etc. been conducted in the case of the assessee? If so, is the copy of such audit report available on record?
10. Does the test check of accounts confirm that the assessee has not manipulated the arithmetical accuracy of the accounts?

After the preliminary examination of books of accounts is complete, the specific areas need to be looked into. There is no mathematical formula for detection of concealment, as the assessees regularly changes the methods of tax evasion to suit their own requirement. Ratio analysis discussed earlier will be helpful in selecting the area for investigation. However, there are certain techniques, which may prove to be effective for detection of concealment. These are discussed with reference to different items appearing in the books of accounts.

3.5 Inflation of Cost/ Purchases and Suppression of Production/ Sale

Inflation of cost/ purchase and suppression of production/ sale are the most commonly used methods for concealment of income. The intention is to over debit or under credits the trading or manufacturing account resulting in reduction of gross profit and consequently the net profit. It is done by manipulating quantity and value of the goods purchased and goods sold. The transaction is recorded in the books of accounts but the correct quantity and/ or cost is not entered. Sometimes, it is possible that the transaction may not be entered in the books of accounts at all, e.g. a cash sale may not be recorded in the books of accounts. The production is basically manipulated in quantity in the first place and consequently the value will also be suppressed. Such suppressed production will be sold in cash and no entry for the same will be made in the books of accounts. The cost of goods is generally manipulated in value alone.

However, there are certain limitations on inflation of purchase or suppression of sale. To clarify this point, it may be mentioned that if the purchaser is insisting for a bill, it will be difficult for the seller to keep the transaction outside the books of accounts. Similarly, if the customer is making full payment by cheque, it will be difficult for the seller to keep the transaction outside the books of accounts. Even though inflation of purchase and suppression of sale achieve the same result, certain situations prevailing in the market limit the scope of the assessee to choose the method of manipulation.

Normally, the inflation of purchase is done in following situations (illustrative):

1. Sale price is pre-determined.
2. Purchase price is low and margin of profit is high.
3. The sale price is received by cheque.
4. Bill has to be issued for each item sold.
5. Premium is required to be paid, while purchasing the material.
6. Gratuitous purchases.

Normally the suppression of sale is done in the following situations (illustrative):

1. A number of sales transactions are in cash.
2. The item being sold is a fast selling item.
3. The purchase price is regulated or predetermined.
4. Production suppression.
5. Gratuitous sales.

Thus the investigator after taking into consideration, the different aspects of the assessee's business may select the area, which requires detailed investigation.

3.6 Methods of Manipulating the Accounts

The methods of manipulating the accounts and its effects are discussed below in brief:

a. Inflation of Purchases

S. No.	Description	Quantity	Amount
1.	Bogus Purchases	Not recorded.	Value recorded
2.	Over invoicing	Recorded correctly.	Value is enhanced
3.	Earlier/ later purchases are included	Recorded, but manipu-lated	Record, but manipulated
4.	Purchase of inferior goods shown as superior goods.	Recorded correctly	Value is enhanced
5.	Purchases recorded at high price zone.	Recorded correctly	Value is enhanced
6.	Purchasing non saleable goods and subsequently writing off of stock as bad/ unsaleable, etc.	Recorded correctly	Recorded correctly
7.	Not recording purchase return.	Not accounted	Not accounted

b. Suppression of Sale

S. No.	Description	Quantity	Amount
1.	Sale outside the books	Not recorded	Not recorded
2.	Under invoicing	Recorded correctly	Value is reduced
3.	Excluding the sales at the beginning/ end of the year.	Recorded correctly	Value is reduced
4.	Sale of quality goods shown as sale of sub-standard goods.	Recorded correctly	Value is reduced
5.	Sales are pushed to low price zone.	Recorded correctly	Value is reduced
6.	Sales return	Recorded correctly	Value is enhanced

c. Inflation Cost of Production: Cost of production is inflated by showing excess consumption of (1) raw material (especially costlier components), (2) power, oil etc. (3) stores and spares and (4) getting the job work done from outside on higher cost.

d. Suppression of Production: The production is suppressed by showing the yield of finished product at a lesser ratio than the correct ratio. The suppressed production is kept totally outside the books of accounted and is not recorded in the production register or the stock register. Similarly, the by-product is kept totally outside the books of accounts or recorded at lower quantity in the relevant registers.

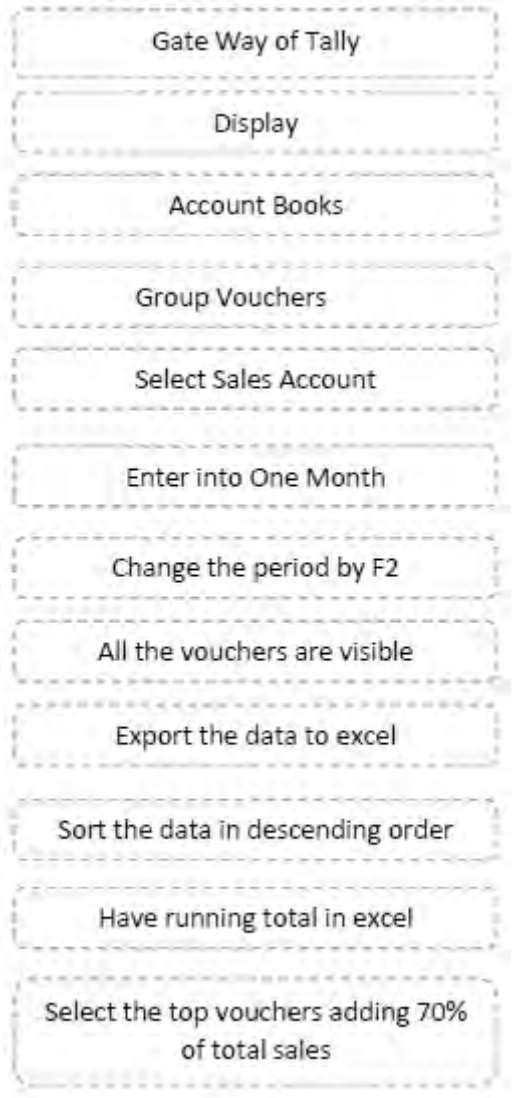
3.7 Examination of Transactions of Purchase and Sale

In order to get more insights into the transactions related to sales and purchase, it will be very helpful if certain preliminary steps are taken. Let us take an example, where data is maintained in Tally.

a. High Value Sale/ Purchase Invoices

There are thousands of sales invoices and practically it is not possible to check all the vouchers. If we want to verify the maximum turnover in minimum possible time, then we must follow ABC Analysis approach. In general, there are 20 to 30% of vouchers that can add upto 70–80% of total sales. With the use of tally and excel we can make a list of high value sales vouchers, which will add upto 70% of total sales.

STEPS TO SELECT HIGH VALUE SALES INVOICES



b. List of Cash Sales/ Purchase Transactions

A list of cash sales transactions can be extracted through tally. Follow the steps given below.

STEPS TO SELECT TOP 10 DEBTORS

Gate Way of Tally

Display

Account Books

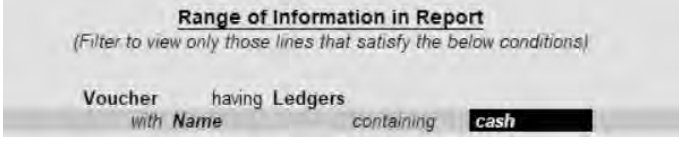
Sales Register

Enter into One Month

Change the period by F2

Press Alt+F12 for Range

Give the conditions as given below



This report can be exported to excel. A ratio of cash sales to total sales can also be calculated to understand the nature of business.

Note: *Whatever reports we have generated for Sales the same can also be generated for purchase transactions.*

In medium and small scale cases, inflation of purchase and suppression of sale generally takes place in the last few months of the financial year. This is because that the assessee comes to know about higher income in the said period and then makes attempt to reduce the profit. As against this, suppression of production is normally practised throughout the year.

The costlier components which form substantial part of the cost/ production/ purchase/ sale are more likely to be manipulated, as it enables the assessee to achieve higher results by manipulating small quantity. The U.R.D. (Unregistered Dealer) purchases/ sales are exception to this general rule.

The Investigator will benefit by resorting to three types of verification *viz.*

1. Verification of flow of goods and material
2. Verification of the physical aspect of transaction and
3. Verification of financial aspect of the transaction.

Verification of flow of goods and material will require preparation of a flow chart of incoming goods and material, outgoing goods and material and stock available with the assessee at end of the period. The chart should preferably be prepared for 26 fortnights of the year. But if preparing fortnightly chart is difficult, then at least monthly chart should be prepared. This will reveal the availability of goods and material as against the position of sale. Any substantial deviation from the normal flow should be viewed with suspicion and a detailed examination of the transactions in this period of substantial deviation should be made. Such examination of flow of goods and material have yielded good result in some cases as sales were recorded at such time when the assessee was not having sufficient stock or even 'nil' stock. Such examination of flow and material will also enable the investigator to view the transactions in a proper perspective *vis-á-vis* the prevalent market conditions at the relevant time.

Verification of physical aspect of transaction involves ascertaining of the following:

1. Mode and date of order.
2. Quantity and price agreed.
3. Mode of transport (Railway/ Lorry receipt).
4. Delivery challan with octroi marking.
5. Sales/ purchase invoice.
6. Inward and outward registers (Factory/ Godown).
7. Subsidiary books (Sales/ Purchase/ Sales Return/ Purchase Return Registers).
8. Stock Ledger.

Verification of financial aspect is to ascertain how the receipts/ payments are accounted for. The investigator should ascertain (1) whether the payments/ receipts are effected in cash or by cheque (2) whether payment/ receipts are in full, in part or not made at all and (3) whether incidental charges, such as commission, brokerage, transport charges etc. were actually paid or are shown as outstanding.

3.8 Examination of Purchases

Purchases should be test checked with reference to the vouchers. Purchases in cash and on credit of near about the same date should be compared to find out inflation in cash purchases. Purchases in the rising market should be seen with suspicion. Similarly, purchases in the last two months of the year should be examined with reference to sales and closing stock.

Examination of purchase bill is very important for detecting inflation of purchases. It is a common knowledge that certain hawala dealers earn their daily bread by giving bogus receipts and invoices. As discussed earlier attempts to inflate sale are mostly made in the last few months of the year. The invoices/ receipts are acquired much later and in several cases, months later. As the Bard has said, "To err is human". It is, therefore, necessary to examine carefully, the invoices and receipts. The invoices with same pattern of printing but giving different addresses should be marked for detailed examination. Similarly, invoices which appear to be new as compared to the other invoices of the same period and invoices which are not torn or mutilated at the concern or the invoices which do not carry a mark of having been folded in the past or having been stapled or pinned in the past should also be marked for detailed examination. The date of the bill is also likely to give a good clue, as the bills are actually prepared much later than the date on which the transaction is supposed to have taken place. The whole-sellers of a particular commodity are normally located in a particular area. The invoice having address of a locality other than the locality in which the whole-sellers are located should also be viewed with suspicion. In suitable case, information from the bank should be called to find out the

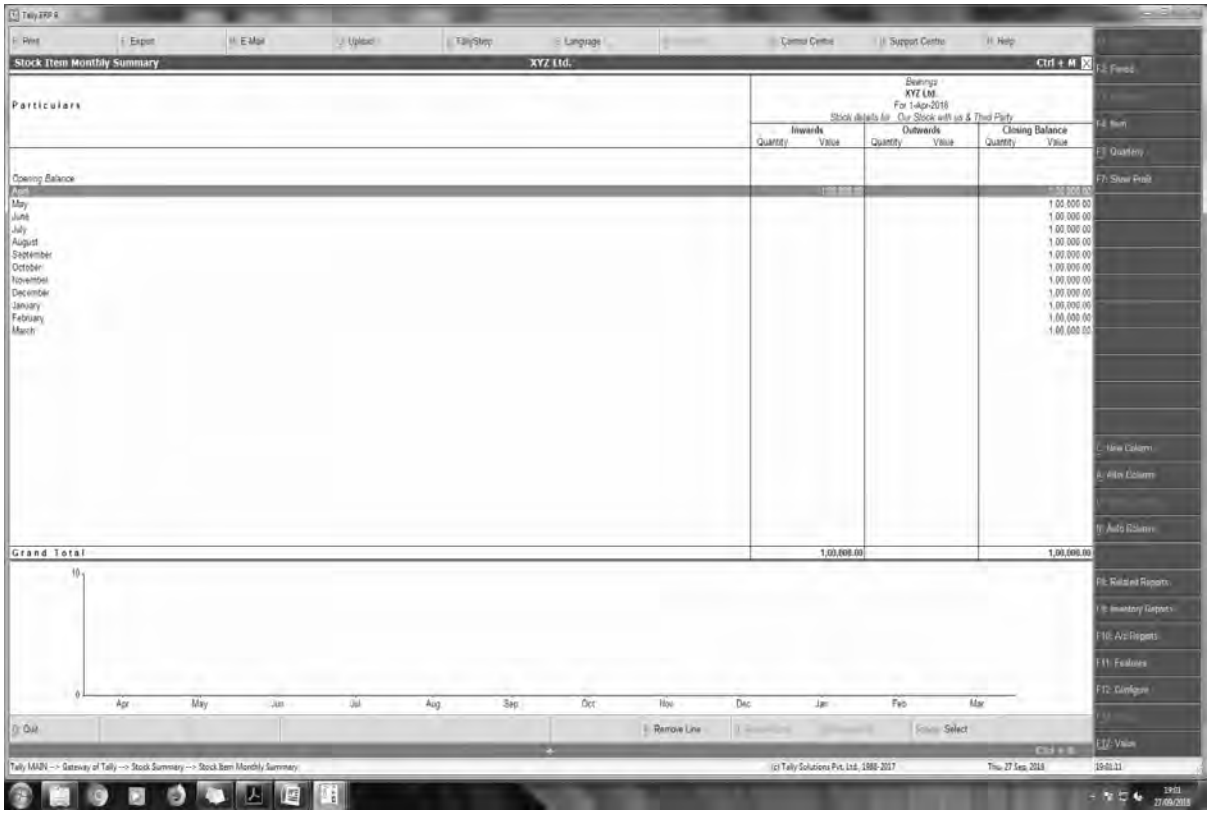
names of the payees to whom the payments have ultimately been made. Purchases related to Sundry Debtors which are outstanding for a long time should also be examined in detail. Detailed examination should also be made in respect of goods and material imported, especially in view of the fact that cases have been found where the purchasers have either sold the import licences or have sold the material imported in market for cash consideration. In such, cases the import documents should be scrutinised and the reverse side of import license should be verified for any endorsement there on.

Different methods of inflation of purchases have been discussed earlier. The verification of such purchases is discussed below:

1. **Bogus Purchases:** In this method, the quantity of goods is not recorded but the value is recorded. In this method the purchase consideration paid is normally received back in cash. Since the goods have not been received, the assessee will find it difficult to produce the documents required for physical verification or the assessee may produce bogus documents. Verification of financial aspect such as following up of cheque to find out the end receiver will be useful in this method.

The above query could be verified in data maintained in Tally Software through following steps.

The following screen appears on following the above path in Tally software:



2. **Over Invoicing:** Since the manipulation will be in terms of the value, the verification of quantity is not necessary. Purchase invoice should be compared with invoices of other purchases around the same time. Since the higher amount paid is received back by the assessee in cash, following up of cheque will also be useful.

3. **Earlier/ Later Purchases Recorded In Current Year:** This method is resorted to when the gross profit manipulation is required in a particular year. The purchases in the last month and consequently the closing stock will be high. Sundry debtors and sundry creditors will be disproportionate. Since the purchases of earlier/ later year are to be recorded, quantity as well as value is manipulated. Financial test will not be relevant in this method but physical verification will be necessary to prove that though the assessee has recorded the purchase, the goods have not been physically received by the assessee.

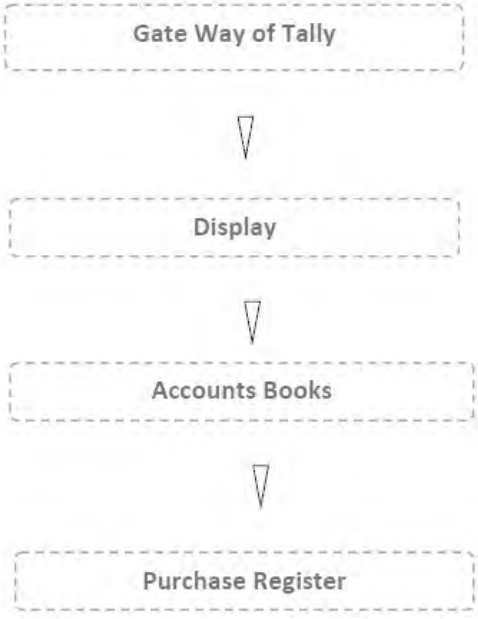
4. **Purchase of Inferior Quality Recording Superior Goods:** In this method, sub-standard goods are purchased at the price of quality goods. To give an example the dealer of ready-made dresses may purchase goods termed as 'seconds' and will record the value at normal price. The goods will however be sold at lower rate as 'seconds' thus reducing the profit. The purchase documents will have to be verified in this case and rates will have to be compared. The following up of the cheque will also be useful.

5. **Purchases Recorded at High Price Zone:** To give an example, the edible oil dealer will purchase goods soon after the new groundnut crop comes to the market, since the edible oil will be cheaper at that time, but the date of purchase is shifted in the books of accounts to the period in which prices were high. The verification of flow of goods will be useful in such cases. Fortnightly or monthly stock tally will be necessary to verify the flow of goods. Similarly co-relating the purchases with payments will also be useful.

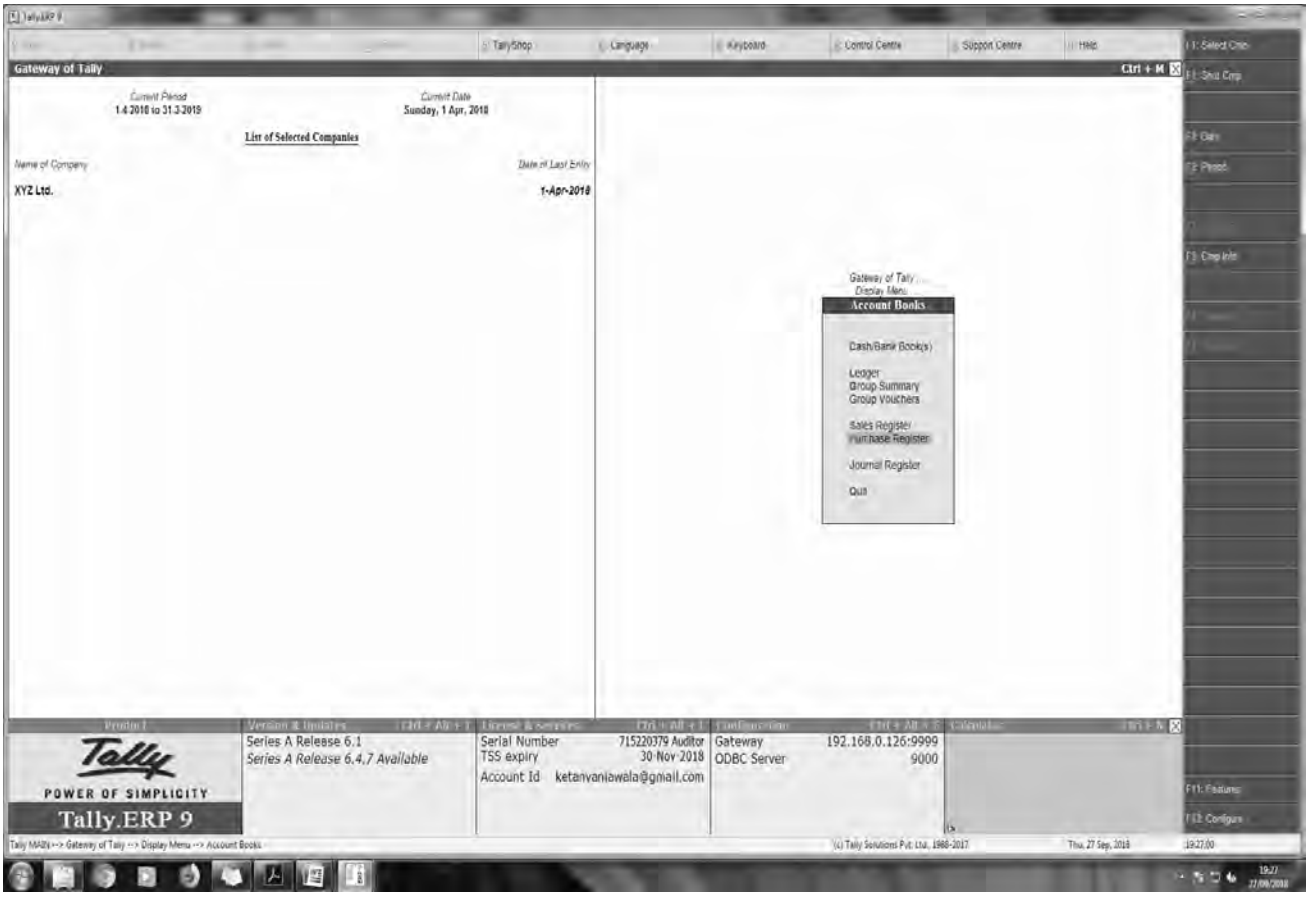
6. **Purchasing Non-Saleable Goods as Standard Goods and Subsequently Writing Off of Stock as Bad/ Unsaleable etc.:** The quantity and value are both correctly recorded. The purchase consideration paid is subsequently recovered in cash. Sometimes the goods sold without bills are adjusted in this method by regularly writing off certain percentage of goods as bad/ unsaleable. The Investigator should verify the method of disposing of the goods written off as bad/ unsaleable. Certain exciseable goods written off as bad/ unsaleable are to be disposed off in the presence of excise authorities. Enquiries may, therefore, be made with excise authorities in suitable cases. Follow up of cheque payment may also be useful.

7. **Not Accounting Purchase Return:** Purchase return reduces the total purchases. Hence sometimes the assessees do not record purchase return to avoid reduction in the amount of purchases. This results in certain quantity of goods going out without any consequential reduction in the value of purchases. This is subsequently adjusted as shortage of stock as a result of weight loss or loss in transportation. Normally, the purchase consideration, though paid, is not received back by the assessee on purchase return as it is normally adjusted in running account. The verification of running account of purchases and detailed verification of goods written off will be useful in such cases.

For point no. 2 to 7, though Tally does not provide an analysis directly, but to review each and every purchase, one can take support of purchase register wherein, the quantitative and value part are reflected. The Purchase register can be viewed through following path.



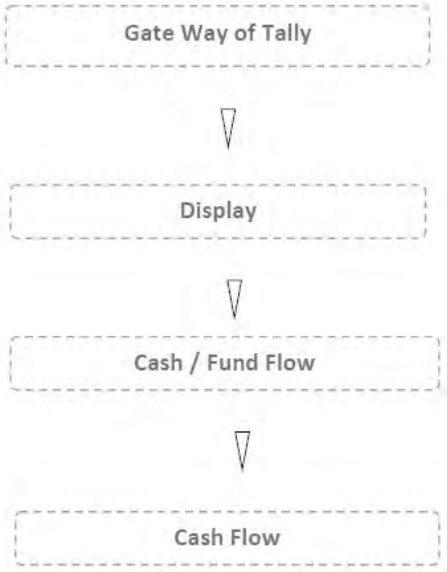
e.g.

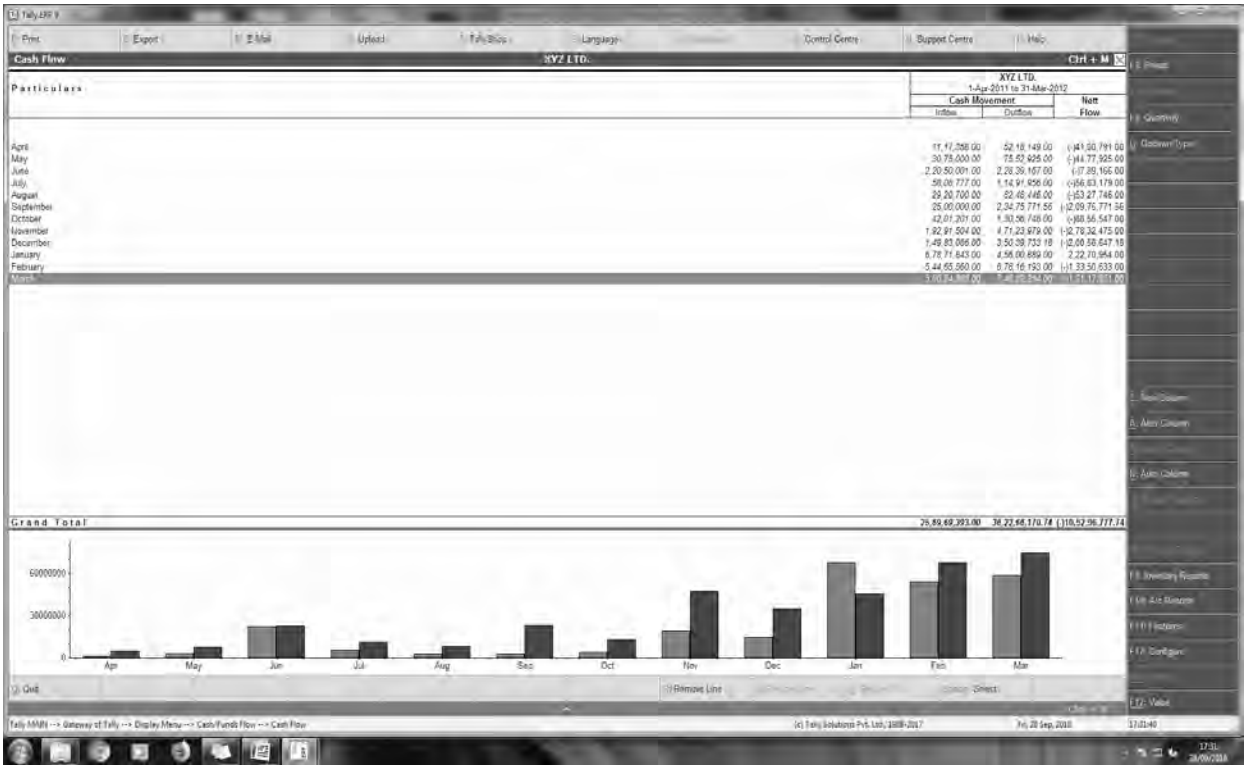


3.9 Examination of Sales

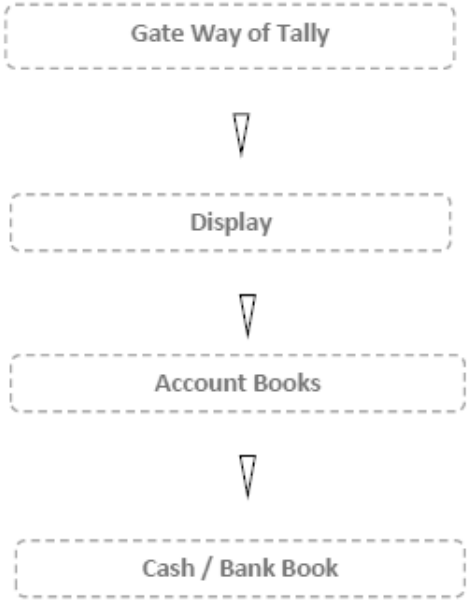
Suppressing or under-stating the sale is another common method for concealment of income. Many a times, the sales are also manipulated by introducing intermediaries in between or by fabricating bogus forward contracts. Such cases should therefore be examined in detail. The Investigator should examine the sales near about the date of change in excise structure for possible manipulation. Similarly, sale of large stock in falling market or before abnormal price rise should also be examined. If an item is a controlled item, it should be ascertained whether there was any increase in price announced by the Government. In such cases, there is a possibility of huge profit on existing stock and the assessee may conceal such profit through fictitious sales at lower price. Also the large cash sales made at the end of the year should be viewed with suspicion. Sometimes sales proceed may be directly credited to the personal accounts and are subsequently squared up. The Investigator should examine such transactions. Sale of waste/ scrap and by-product should also be examined. On certain dates, the assessee may be in need of large amount of cash. It is likely that he may introduce cash available with him on these days by showing fictitious sales. The Investigator should, therefore, study the cash flow and cash sales just prior to large requirement of cash in detail. Consignment sales should also be examined.

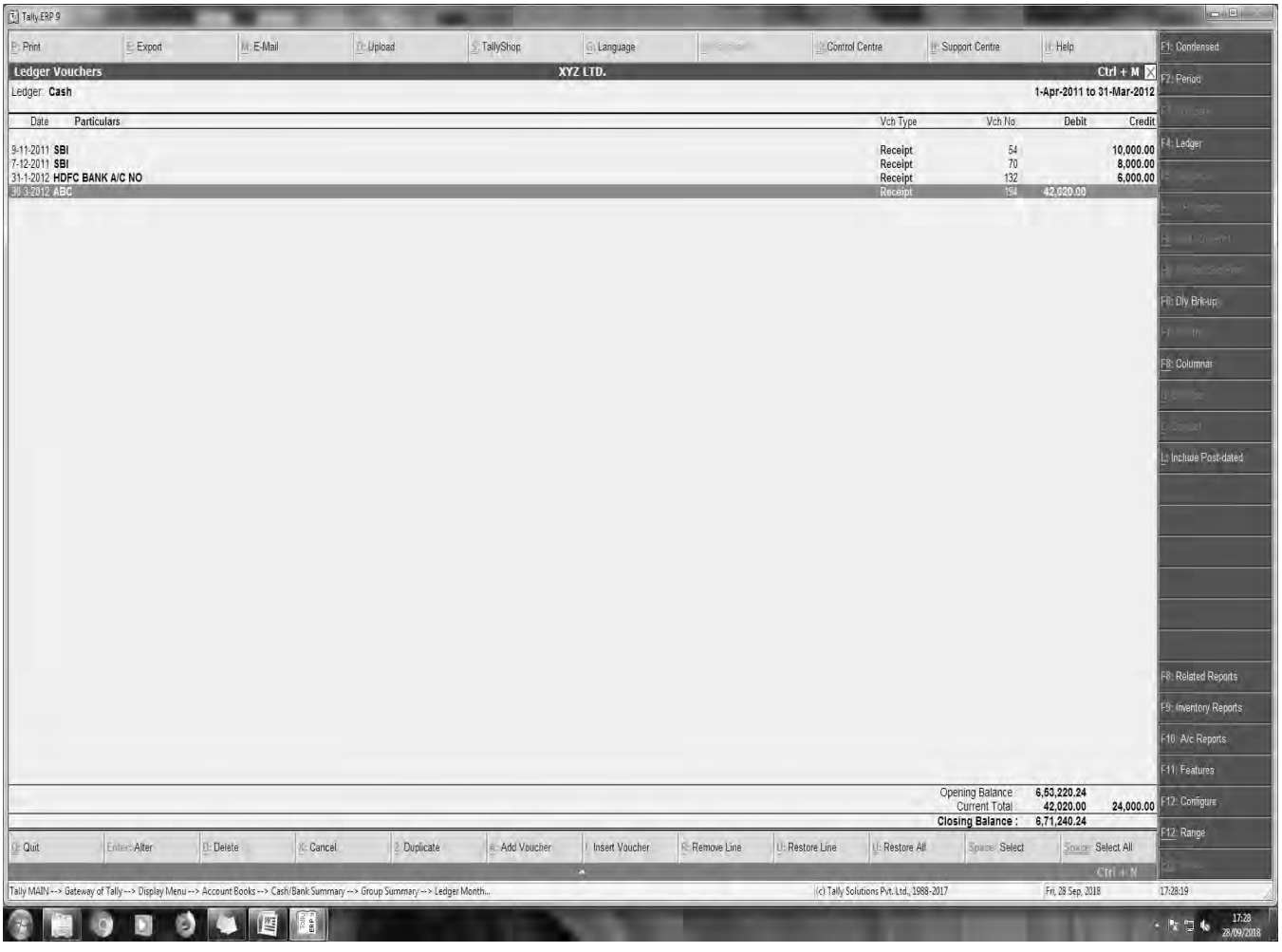
Cash Flow can be viewed through following path in Tally -





Further, to investigate in respect of "Cash Sales", we can also view "Cash Account" by following path:





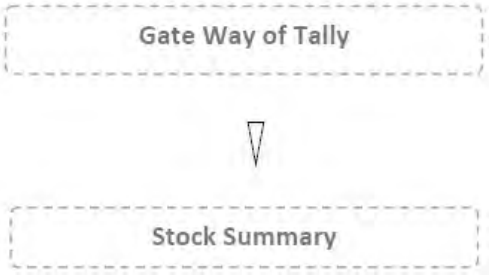
Above screenshot of "Cash Book" shows that there is cash receipt of Rs. 42,020/- in the name of "ABC" personal account, as mentioned in above para, which may be squared up subsequently.

The investigator should compare the rates of sale made in cash and on credit. He may also call for relevant information from other authorities such as excise, customs, sales tax, octroi, bank etc. for cross verification.

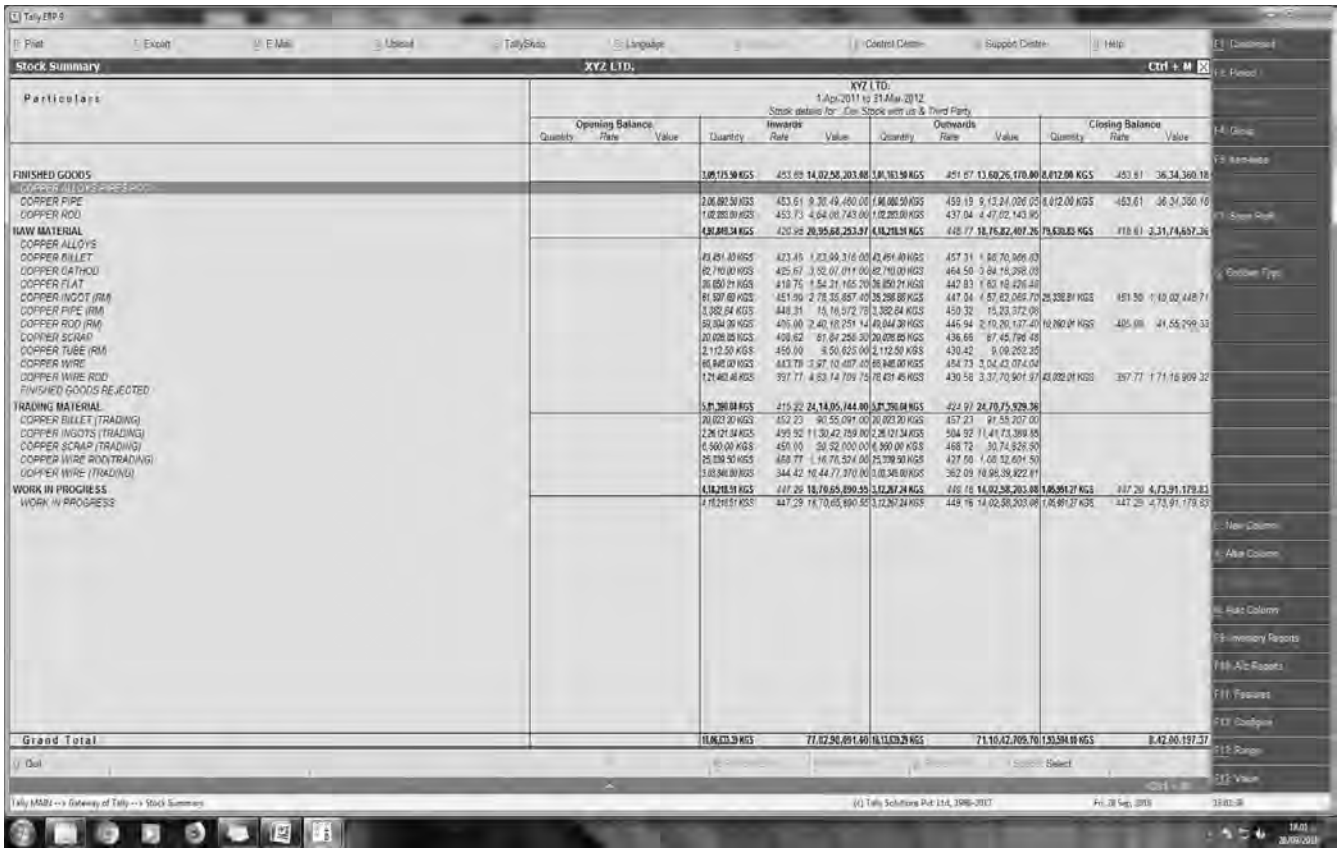
In the business establishments having large number of cash sales during the day, such as expensive restaurants and cloth shops, which are selling expensive sarees and garments, it was noticed in some survey and search actions that the computers were programmed to exclude certain sales transactions from the statement of sale. The Investigator should therefore, take care to verify this aspect during the course of survey or search by running a dummy programme. Different methods of suppression of sale have been discussed earlier. The verification of such sales is discussed below:

1. **Sales Outside the Books:** Since the sale is totally outside the books of accounts, it makes the work of Investigator, difficult. However, the study of flow of goods, verification of item wise quantitative tally and calling for accounts of old sundry creditors may yield results.

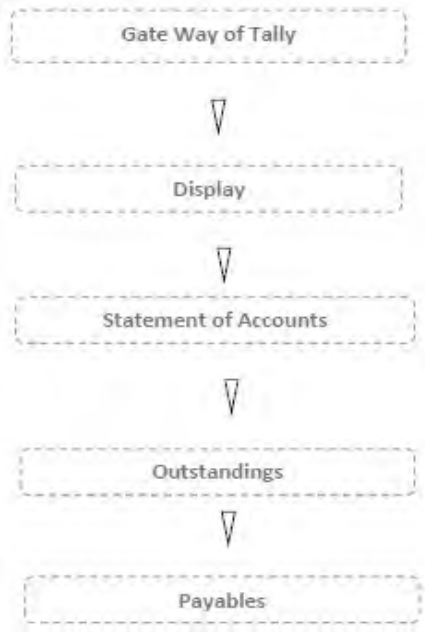
For the purpose of investigating into the movement of the stock, "Stock Summary" can be viewed through following steps:



e.g.



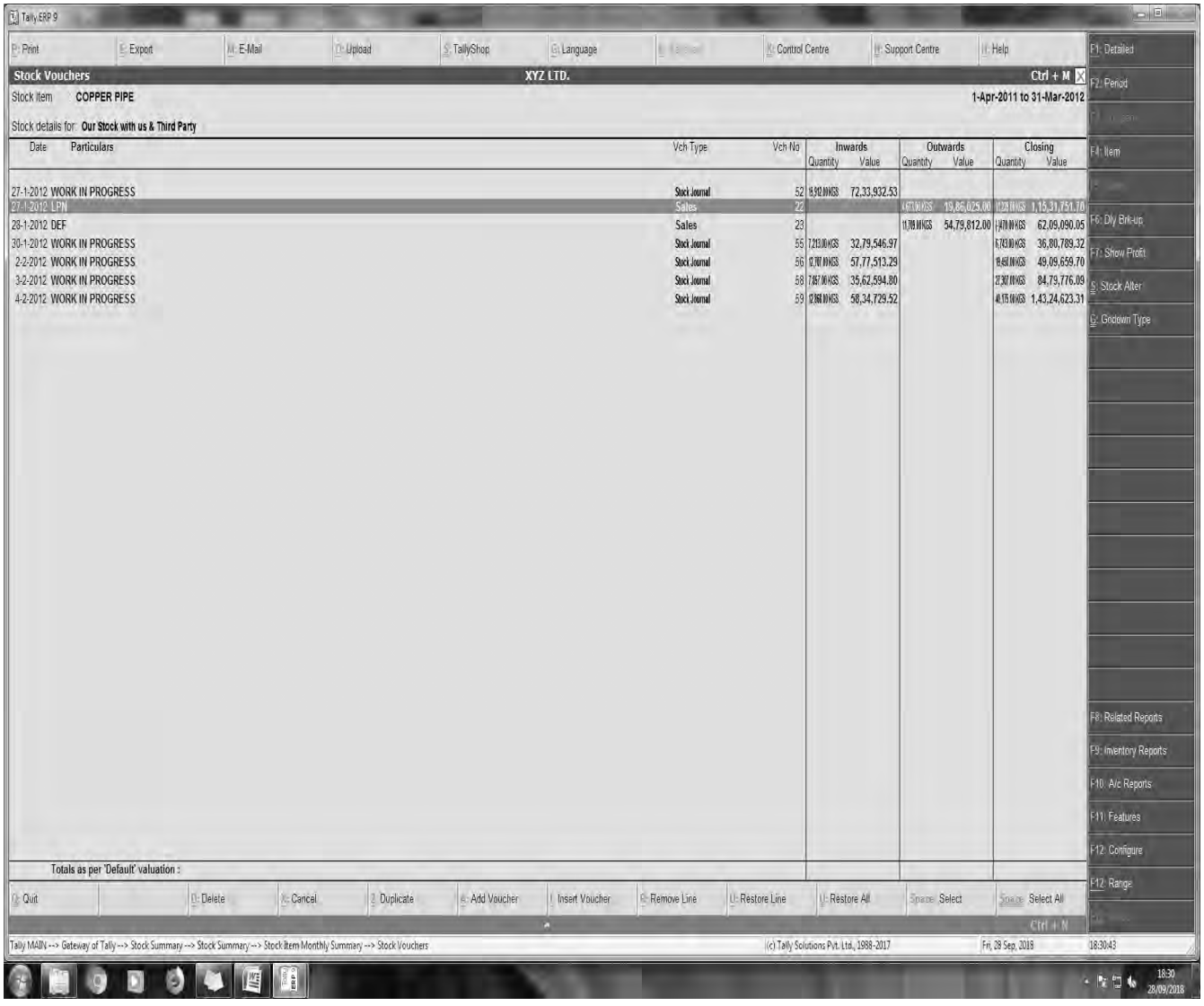
Further, to view the 'ageing' (Old Sundry Creditors) of the creditors, below mentioned path can be followed.



e.g.

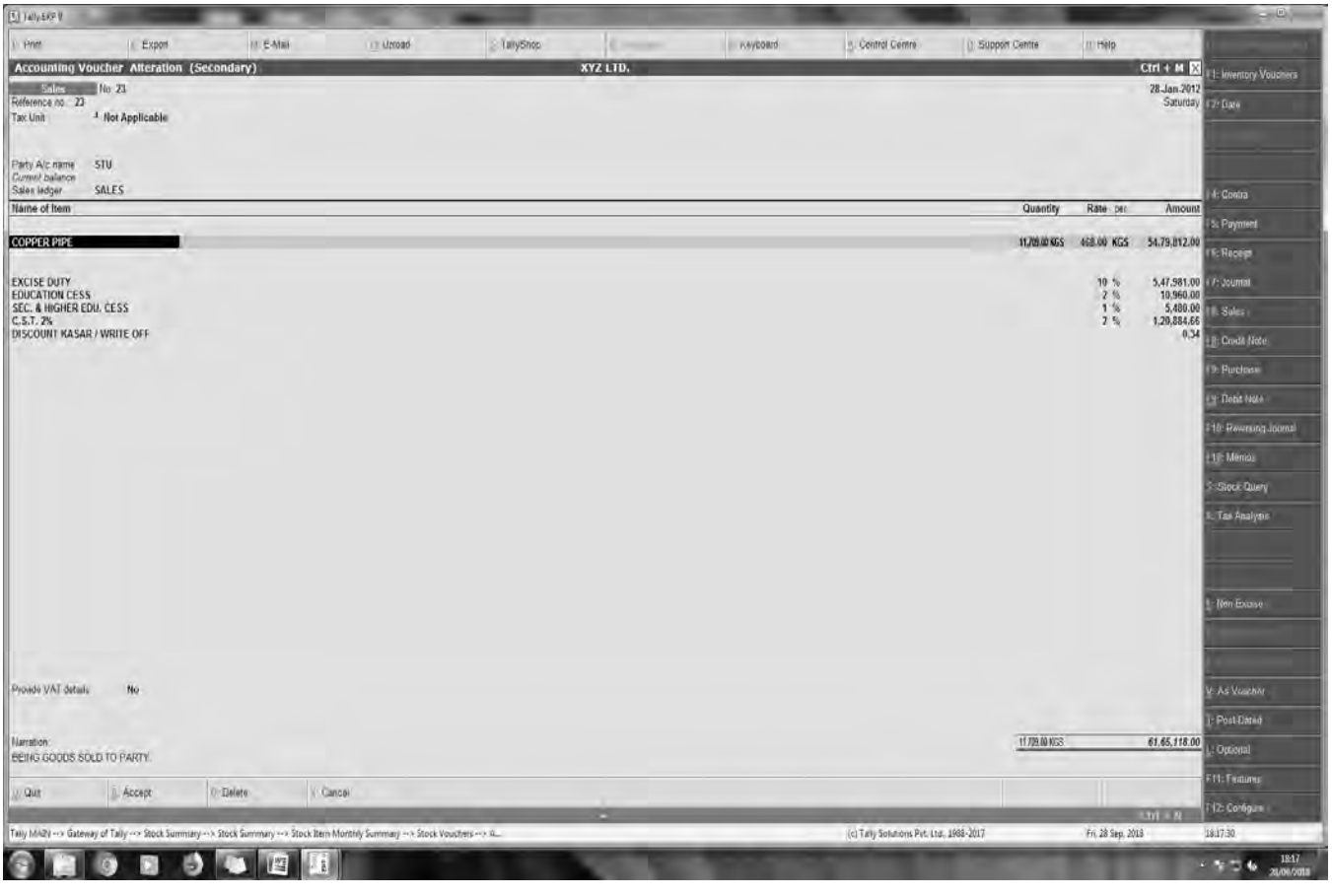
2. **Under Invoicing:** In the cases of under invoicing, the quantity is recorded correctly but the sales price is suppressed. Unrecorded portion of sales price is recovered from the purchaser in cash or in kind. A comparison of sales price in different transactions and co-ordination with other authorities may be useful in this regard.

The comparison of sale prices can be viewed by observing 'movement of stock' as below:



Further, to view the difference in the rates of sale price, following illustrative vouchers can be taken into consideration. It could be seen here that sales price charged on a given date for the same products is different (i.e. price per Kg is Rs. 425 & Rs. 468) which clearly points towards Under Invoicing.

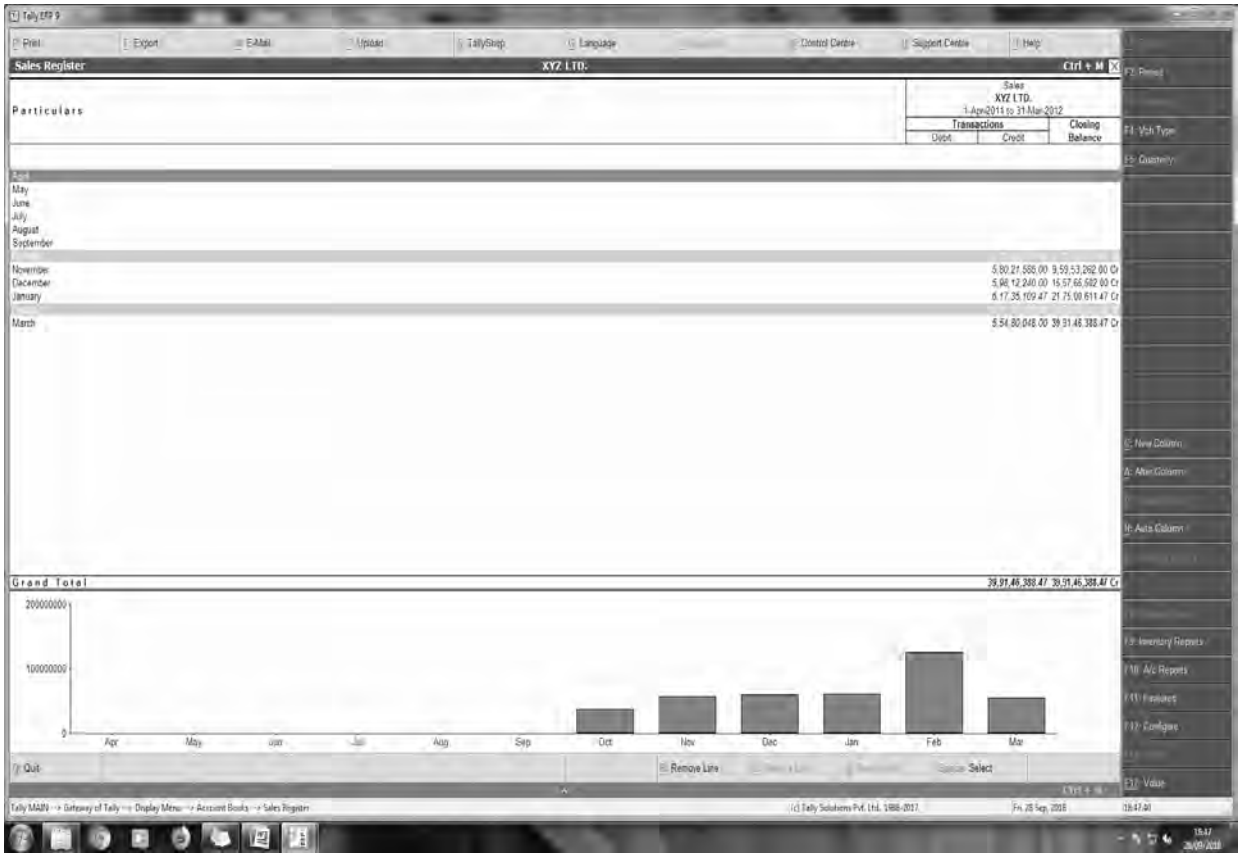
Accounting Voucher Alteration (Secondary)
XYZ LTD.
Ctrl + M
Sales No. 22
Reference no. 22
27-Jan-2012
Friday
Tax Unit : Not Applicable
Party A/c name : PRQ
Current balance
Sales ledger : SALES
Name of Item
Quantity
Rate per
Amount
COPPER PIPE
4,673.00 KGS
425.00 KGS
19,86,025.00
EXCISE DUTY 10 % 1,98,603.00
EDUCATION CESS 2 % 3,972.00
SEC. & HIGHER EDU. CESS 1 % 1,986.00
OUTPUT VAT @ 4% 4 % 87,623.44
OUTPUT ADD. VAT @ 1% 1 % 21,906.00
DISCOUNT KASAR / WRITE OFF (-)0.44
Provide VAT details : No
Narration:
BEING GOODS SOLD TO PARTY
4,673.00 KGS
23,00,115.00
Quit
Accept
Delete
Cancel


Accounting Voucher Alteration (Secondary)
XYZ LTD.
Ctrl + M
Sales No. 23
Reference no. 23
28-Jan-2012
Saturday
Tax Unit : Not Applicable
Party A/c name : STU
Current balance
Sales ledger : SALES
Name of Item
Quantity
Rate per
Amount
COPPER PIPE
11,709.00 KGS
468.00 KGS
54,79,812.00
EXCISE DUTY 10 % 5,47,981.00
EDUCATION CESS 2 % 10,960.00
SEC. & HIGHER EDU. CESS 1 % 5,480.00
C.S.T. 2% 2 % 1,20,884.66
DISCOUNT KASAR / WRITE OFF 0.34
Provide VAT details : No
Narration:
BEING GOODS SOLD TO PARTY.
11,709.00 KGS
61,65,118.00
Quit
Accept
Delete
Cancel

3. **Excluding the Sales at the Beginning/ End of the Year:** Comparatively low sales at the beginning or end of the year may be an indication of the shifting of sales to different period. In such cases, the assessee may temporarily change the method of accounting for recording the sales at the time of despatch of goods to recording the same on receipt of order or vice-versa. The quantitative records are then manipulated, as they cannot be written in orderly fashion. The Assessing Officer may examine the quantitative tally which will show that goods have physically gone out but the value is not recorded.

To have a look into the month-wise comparison of sales, sales register can be viewed through following path:

e.g.



4. **Sale of Quality Goods Shown as Sale of Sub-Standard Goods:** The sales value is manipulated by lowering the same but the quantity remains the same. Since the Investigator is investigating the matter after a gap of time, it will be difficult to prove that good quality material was sold as sub-standard goods. The same can be identified by viewing sales register as mentioned in Serial No. 2 'Under Invoicing'.

5. **Sales Pushed to Low Price Zone:** Taking earlier example of edible oil dealer, the goods sold when the prices were high may be shifted in the books of accounts to the period when the price was low immediately after the new crop of groundnuts. The verification of flow of goods will be useful in such cases. Fortnightly or monthly stock tally will be necessary to verify the flow of goods. Similarly co-relating sales with receipts will also be useful. The same can be identified by viewing sales register as mentioned in Serial No. 2 'Under Invoicing'.

6. **Sales Return:** Sales return reduces the total sales. The quantity of sales return is recorded correctly but the sales are reduced by inflating the figure of value. The Investigator should, therefore, relate the sales return to its sale to ensure that the value is not reduced. Cash sales and subsequent sales return are sometimes used to temporarily bring in unaccounted cash at the time of need. If accounted cash is not available when required, the assessee may introduce unaccounted cash available with him by showing cash sale and withdraw this cash from business whenever sufficient accounted cash is available by showing sales result. The Investigator should, therefore, examine the cases of sales return, whenever the related sale was a cash sales.

The same can be identified by viewing Sales register and cash book, as mentioned in *"Examination of Sales"*.

3.10 Manufacturing Expenses and Direct Expenses

Apart from the gross profit rate, percentage of yield from raw material consumed should be compared with the ratio of yield in the earlier years and also with the yield in the other comparable cases. In any manufacturing activity, the quantity of product manufactured generally bears a more or less definite proportion to the quantity of raw material/ power consumed. Any major deviation from the yield ratio should be viewed with suspicion. The assessee may try to say that yield was low due to lower quality of raw material. In such case, the Investigator should verify whether the question of lower quality of raw material was taken up by the assessee with the supplier of the material and should also verify the rate at which the raw material was purchased and whether lower rate was paid to lower quality material.

The same can be identified by examining the 'Yield Ratio', in *'Ratio'* Section, as mentioned above.

By-product and wastage also generally bears a more or less definite proportion to the quantity of raw material consumed. It is therefore, necessary that these two items are also verified in the same manner as the yield of finished product to raw material. The same can be identified by examining the 'Yield Ratio', in *'Ratio'* Section, as mentioned above.

The units of electricity consumed or the quantity of other types of fuels consumed should also be taken into consideration for estimating the manufacturing result. It will also prove to be helpful when the assessee is accounting for production but is in fact not manufacturing anything, such as a case where the assessee has shown manufacturing of stainless steel utensils but has sold the imported stainless steel sheets in black market, was confronted with meagre consumption of electricity by the factory. The same can be identified in Tally accounts by referring and comparing respective expense account in Statement of Profit & Loss.

The investigator should verify the production register and other relevant registers maintained in the factory. He should verify that the production in terms of quantities shown from stage to stage commensurate with the quantity of raw material and power/ fuel. Central excise

specifications can be taken as standard for the consumption of raw material, wherever applicable. Production machine manuals can also be taken as basis for consumption of raw material. Job-work standards can be applied to ascertain the raw material consumption. The Investigator may consult an expert in the field, if necessary. In suitable cases, the Investigator may visit the factory with the permission of higher authorities to gain firsthand knowledge of the manufacturing process. The cost audit reports prescribed for certain manufacturing activity may be obtained for critical appraisal of the cost incurred under several heads such as raw material, stores, wages, power/ fuel etc. so that it may be possible to compare similar percentage shown by other assessees and to pin-point the aspect which requires further scrutiny. The consumption of costlier components should be thoroughly checked as least manipulation thereof gives maximum results.

In a pen manufacturer's case, gold was purchased for manufacturing of nibs and consumption was shown at higher rate than the actual consumption. It resulted in higher cost inflation with least manipulation. Substantial quantity of gold was found during the course of search and seizure in this case. Stock written off as damaged or spoiled, should also be checked. If abnormal rise in any particularly expenditure is shown, detailed scrutiny regarding the claim should be made.

3.11 Opening and Closing Stock

The figures of quantity and value of the closing stock should be checked with the last year's closing stock. The Investigator should also check the statement of stock filed and verified by the Officer of the bank from which the assessee has obtained loan on hypothecation of stock. The stock register maintained by the assessee should be test checked and flow of stock should be examined. It should also be ascertained that the assessee has not changed the method of valuation of stock. It should be verified that stock in respect of (a) raw material (b) goods in process (c) consignment goods in transit (d) stock with the branches and (e) finished goods have been separately and correctly shown. Purchases made in the closing period of the months should be examined with reference to the sales of those items to verify the balance stock and to tally it with the closing stock inventory. The valuation of the stock should also be checked.

3.12 Gross Profit

As mentioned earlier, like should be compared with like for analyzing the gross profit ratio. The fall in gross profit is only a starting point for enquiry and not an end in itself. The Investigator should give specific findings about the area of manipulation made by the assessee. The area of manipulation may be sales, purchase, opening stock or closing stock. After recording specific findings, the Assessing Officer during the assessment proceedings should reject the book results by invoking the provisions of Sec. 145(3) of income-tax Act. *The correct value of the item in the manufacturing or trading account which is not accepted by the Assessing Officer, should thereafter be found out by adopting the following formula by taking the item of which the value is to be found out at 'X'.*

$$Sales = \frac{100 \times (Purchase + Opening\ Stock - Closing\ Stock)}{(100 - Desired\ rate\ of\ gross\ profit)}$$

After ascertaining the value of 'X', the Assessing Officer should recast the manufacturing or trading account and arrive at the correct amount of gross profit. If, however, the Assessing Officer concludes that the direct expenses have been inflated, then addition should be made in respect of such inflation.

3.13 Profit and Loss Account

The debit side of the profit and loss account should be examined for possibility of the assessee having inflated the expenditure. Any new item of expenditure or new item of income like interest, commission, profit on sale of assets etc. should also be examined in detail.

Claims of various expenses should be compared with the claims in the previous years. Large payments to allied/ connected concerns should be scrutinised. Debts on account of trading losses should be carefully examined to verify the correctness and genuineness of the same. Provisions made as distinguished from actual expenditure should be examined. The Investigator should also examine whether the personal expenses of proprietor/ partners are passed on as business expenses. Generally the expenses claimed in profit and loss account should be tested for reasonableness. Disallowance should be made on specific ground.

3.14 Balance Sheet

Balance Sheet is not an account as such but it is a statement indicating the financial position of the assessee. Concealment of income results in accumulation of unaccounted funds with the assessee. The businessman is always in need of funds for running the business and hence he would not like to keep such unaccounted accumulated funds idle. Though, he may spend part of such funds on personal expenses, the major portion of such funds will be brought back in the business. Such funds will manifest in Balance-Sheet in different forms such as cash credit, introduction of capital by proprietor/ partner, undervalued stock, bogus liabilities etc. The examination of Balance-Sheet is therefore, important for detecting concealed income.

More attention should be paid to the accounts appearing in the Balance-Sheet for the first time, accounts disappearing from Balance-Sheet and accounts remaining untouched for a long period of time. The basic principle is that the totals of assets and liabilities side should tally. If there is excess of assets over liabilities, the difference should be taxed as income, but the vice-versa should be ignored. Normally, the difference in the two sides is transferred to a "Suspense Account". Entries in the suspense account should be carefully examined. In the cases of limited companies, the share capital raised through public issue, especially in the cases of companies owned by business families, should be subjected to scrutiny, as introduction of unaccounted funds through share applications in bogus names has been detected in a number of cases, recently.

The balance in the capital account of proprietor/ partners should be examined with reference to the previous years balance. Fresh credits should be probed. Details of drawings should be obtained to find out its purpose and adequacy of household expenses. Whether the claims for insurance premium, payment of taxes etc. are properly reflected in the capital account is also a point to be checked.

Origin of reserves should be examined. Since the reserves debited in the profit and loss account are to be added to the income of the assessee, it is necessary to find out those reserves which are not debited to the profit and loss account. It is likely that the reserves might have been created by debiting certain accounts like sales, interest etc., directly. In respect of certain specific reserves such as investment allowance reserve, it should be seen whether any such reserve has been drawn during the specific period of 8 years for an object which is not permissible.

Details of security and collateral security given to the banks and financial institutions for obtaining loans should be collected and verified to check whether such securities have been accounted for. If stock is hypothecated with bank, then the inventory of stock filed by the assessee with the bank should be compared with the stock register.

All new cash credits should be examined by calling for the evidence of the source and verification of the credit-worthiness of the creditor. The

existence of the creditor may be verified from the mailing address, GIR/ PAN number and confirmation by the creditors. It is also necessary to verify the squared up accounts, as the assessees generally keeps the bogus loans out of Balance-Sheet and in the process, square up the account before the end of the year. Squared up accounts can be found out from ledger and cash book. Instances of un-ledgerised squared up accounts have also been found, particularly on the dates when large purchases have been affected. It is also likely that on such dates the assessee might have overstated the total of credit side of the cash book or understated the debit side of the cash book in order to introduce the required cash. It is also possible that the assessee may shift the name of the cash creditor to the list of sundry creditors. The details of the sundry creditors should be called for. Balances of cash creditors and sundry creditors appearing for several years should be examined.

The other liabilities and provisions should be scrutinised for remission of liability attracting provisions of sec. 41 and the contingent liabilities.

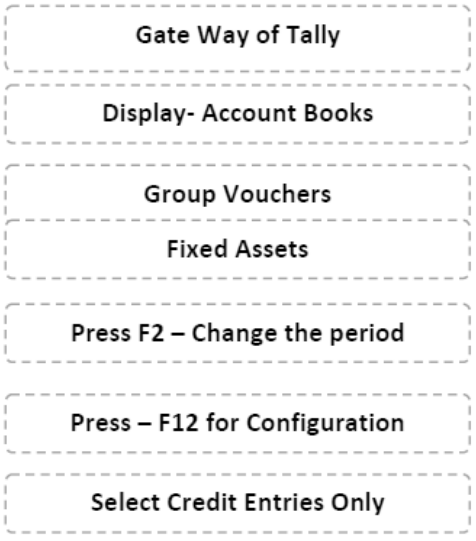
The asset side reflects the application of funds. Details of new assets should be obtained from the assessee and verified by comparing the balances from the previous year. The calculation of depreciation as per income-tax is different from the method followed in books of accounts. As per the provision of income-tax Act, full year depreciation is provided on the assets which are put to use for a period of more than 180 days and half year depreciation on the remaining additions. Hence, it becomes extremely important to check the dates of additions from books as against the dates mentioned in the return.

STEPS TO LOCATE ADDITIONS IN FIXED ASSETS

Source of funds utilised for acquiring new asset should be verified. Claim of depreciation is often used by the assessee for reducing the taxable income. It is therefore, necessary, for the investigator to verify the claim of depreciation and to verify whether the asset was ready for use on the date claimed by the assessee. The log books maintained in the factory and technical manuals may be useful for this purpose.

Reduction in the value of fixed assets through sale or otherwise can be traced in the shortest possible manner using the following steps.

STEPS TO LOCATE REDUCTION IN FIXED ASSETS



If a particular investment has been sold by the assessee during the relevant previous year, it should be ascertained whether the assessee has physically parted with the assets or whether the sale of investment is only a ruse to introduce cash credit. The income from investment should be reconciled with the investment appearing in the Balance-Sheet.

Analysing the various types and number of debtors is very important. For ascertaining the nature, we can do the following in a tally data:

a. Top 10 Debtors/ Creditors

Many times there is a need to call for balance confirmation. A third party confirmation is always considered as the best evidence, but practically it's not possible to call for balance confirmation from every party and then check the same with the corresponding ledger account in the books of the assessee. In case we are short of time then a balance confirmation can be called from top 10 parties, which in aggregate may add up to 70–80% of total sales.

STEPS TO SELECT TOP 10 DEBTORS

By default the report in tally is arranged in alphabetic order and presently there is no option for configuration of the report, hence the amount wise sorting is required to be done in excel.

b. Non-Moving Debtors/ Creditors

Generally the credit period of debtors ranges from 15 days to 3 months depending upon the nature of business. If the debtor is outstanding for a period of more than 1 year then there are chances that it's not a genuine sale but just an entry or its loan party grouped under sundry debtors. The assessing officer must scrutinize such non moving debtors account.

STEPS TO LOCATE NON MOVING DEBTORS

Gate Way of Tally

Balance Sheet

Current Assets

Sundry Debtors

Press F-12 for Configuration

Expand the report

Press Alt F12 for Range

Give the conditions as given below

Note: Whatever reports we have generated for Debtors the same can also be generated for scrutiny of creditors account.

Further, the details of sundry debtors should be called for and a test check should be made to ascertain the nature of debt. The connection of debtors with business should also be verified.

The investigator should invariably call for the bank reconciliation statement. He should also verify whether the cheques issued but not cleared in the last few days of the financial year have actually been cleared in the next year, and the cheques received but not deposited have actually been deposited in the bank and credited to the assessee account in next year. Some of the analysis that can be done in accounts maintained in Tally are as under:

a. Bank Reconciliation

Tally has an inbuilt facility to create Bank Reconciliation. There are couple of ways to get the Bank Reconciliation but the best place where one can find all the reconciliation is banking utility. Follow the steps given below to get all the reconciliation at one place.

STEPS TO LOCATE BANK RECONCILIATION

Gate Way of Tally

Banking

Bank Reconciliation

b. Contra Entries

It is important to check the dates of all the contra entries with the corresponding date in the bank statement. The best way to get all the contra entries at one place in the best possible time is through statistics. Follow the steps given below to get the list of all the contra entries.

STEPS TO LOCATE CONTRA ENTRIES

Gate Way of Tally

Display- Statement of Accounts

Statistics

Contra Entries

Enter into one month

Change the period by F2

The investigator should examine the cash flow and the cash deposits at the time of cash crunch. The examination of cash flow, which can be done on accounts in Tally data is as follows:

a. Negative Cash

Negative cash balance is a situation that generally arises when the payment in cash exceeds the balance of cash reflected in books. Practically the cash balance as per books is not same as the cash actually held by the assessee. If the assessee deposits cash in bank exceeding the balance as reflected in the books then the same will result into negative cash. A negative balance of cash can be interpreted as undisclosed cash and a suitable action can be taken under Section 68 of the income-tax Act.

The cash balance at the end of the year may reflect Dr balance, but there can be instances of Cr balance during the year. The negative cash balance is a ready-made report in tally. The same can be extracted following the steps given below:

STEPS TO TRACE INSTANCES OF NEGATIVE CASH BALANCE

Gate Way of Tally

Display

Account Books

Cash Account

Enter into One Month

Change the period by F2

Press F6 for Daily View

Press Alt+X for Negative Cash

This report can be exported to excel using export utility in tally

b. Cash Payments Exceeding 10,000/-

Cash payment exceeding 10,000/- needs to be disallowed as per income-tax Act. The list of such payments can be extracted using range function in tally. If there are more than one cash accounts then the best way to get the required data is through Group Vouchers.

STEPS TO TRACE CASH PAYMENTS EXCEEDING 10,000/-

Gate Way of Tally

Display

Account Books

Group Vouchers

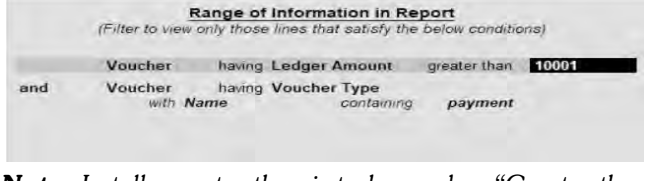
Cash – in - Hand

Enter into One Month

Change the period by F2

Press Alt+ F12

Give the conditions as given below



Note: *In tally greater than is to be read as "Greater than and Equal to" hence the limit is to be set as 10,001 instead of 10,000/-*

This report can be exported to excel using export utility in tally

c. Minimum, Maximum and Average Cash Balance

Cash analysis is a very important area. Since, the volume is big there has to be a systematic approach to start the cash investigation. The first thing that we can do is to check the average cash balance held by the entity throughout the year and then understand the requirement of the same corresponding to the nature of business. The highest, lowest and the average cash balance during the year is directly available in tally.

STEPS TO KNOW AVERAGE, MINIMUM AND MAXIMUM CASH BALANCE

Gate Way of Tally

Display

Account Books

Cash Account

Enter into One Month

Change the period by F2

Press F6 for Daily View

Press F 12 for configuration

Turn High/Low balance option to Y

Grand Total	13,90,488.00	30,55,220.00	10,02,691.85 Dr
Average	9,289.01	8,370.47	8,19,482.21 Dr
Highest Balance	(dt. 15-May-2013) 1,33,459.00	(dt. 1-Oct-2013) 5,32,130.00	(dt. 28-Feb-2014) 11,61,714.85 Dr
Lowest Balance	(dt. 15-Mar-2014) 892.00	(dt. 23-Oct-2013) 150.00	(dt. 6-Jun-2013) 3,84,628.85 Dr

This report can be exported to excel using export utility in tally

d. Summary of all the Cash Payments

If there are lot of cash transactions then a summary of cash payments can be made to know which are the top expenses or top parties to whom the maximum cash payments are being made. If there are more than one cash accounts then the best way to get the required data is through Group Vouchers.

STEPS TO TRACE CASH PAYMENTS EXCEEDING 10,000/-

Gate Way of Tally

Display

Account Books

Group Vouchers

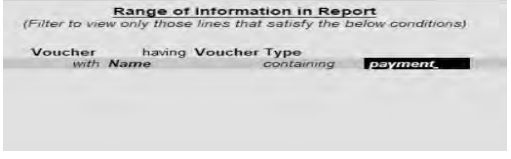
Cash – in - Hand

Enter into One Month

Change the period by F2

Press Alt+ F12

Give the conditions as given below



This will give the list of all the payments made in cash. In order to make the summary of the same the data is required to be exported in excel and with the use of pivot table option a summary can be prepared.

The general principles of investigation of accounts have been discussed in the preceding paragraphs. However, the investigator may come across a modus-operandi peculiar to the case under investigation by him. In such case, the investigation will have to be planned taking into consideration the facts and circumstances of that particular case.

3.15 Other Issues

1. **Separate/ Customised Software:** Apart from the Tally and SAP accounting systems, each business has also developed its own software for accounts and operations. These have been developed keeping the need of the industry in mind. However, some of them are customer specific as well and have features which are unique to the assessee. The investigation into these accounts would be a more case to case basis. For instance, the diamond industry, the activity involves the import of the raw diamonds, polishing of the same and then the manufacture of the jewellery from the same. The software (Lemon etc.) that tracks the raw diamond procurement to the polished diamond is different from the one that tracks the polished diamond to the diamond jewellery manufacturing. The requirement of the industry is that the polished diamond recovery from the raw diamond source is tracked so that the best yielding source is known. The assessee wants to know whether the diamond from one mine yields more or he should go for some other source.

The second software is tracking the cost and sale part for the accounting purposes. So if the actual profitability has to be worked out, then the data from both have to be merged, and the same may also be done internally by the assessee, though not readily available to the investigator.

Another case where separate software is usually maintained is cases where stock is involved- jewellers and manufacturers. Again the purpose is quantitative tallying and recovery measurement but the same does give rise to the possibility of stock adjustment as the data is maintained in standalone systems with no linkage with the entry in the normal accounts. The data of stock is exported in a manual form to the main accounts. Immediate reconciliation of the stock as available in the stock software and that in the books of accounts maintained in other software is to be done. The thumb rule that may be followed is that when the operations are happening close to or in the premise where the controlling persons are there, the possibility of the customised and decentralised software is more likely than otherwise. The investigator needs to collate the data from the operations software with the accounts software. Instances have been noticed where the stock data is not entered in the books of accounts till the month end or quarter end and further, some of the stock data is added at the end of the year only. The investigator needs to examine whether the values, quantities and the wastage have been mentioned in the correct form in the system.

2. **Data Recovery and Data Storage:** In the case of digital evidence, the two crucial aspects as in the case of non-digital evidence, are the recovery and storage of the evidence. The recovery of the digital evidence involves the recovery of the same as contained in the mobile phones, ipads, laptops as well as the desktop systems. Further, some of the data is nowadays stored in the cloud and therefore, is not system specific. Recovery would involve getting access to the data and then obtaining it in a readable form. A large number of software tools are now available which can help the recovery of data from these devices and many of them also help in recovery of deleted data as well. As regards the data which is stored in the cloud, it is important to obtain the passwords before the same can be accessed. The recovery of the data is usually done using forensic tools for imaging by experts who are certified for the purpose. There are vendors existing who have been used by the Department for the recovery of data from these digital sources. It is important to note that imaging of the data is different from the copying of the data

as the deleted files do not get recovered in the copying process. Furthermore, the certified forensic experts give the hash value of the system at the time of recovery of the data and the same is the evidence of data integrity. The hash value that is used is either in MD5 format containing 32 characters or SHA-1 format containing 40 characters, the second being the preferable option. Subsequently when the data or the device is examined or opened, the hash value should tally exactly and that is the proof that no alteration has happened subsequently. The recovered data is stored as a seized item with clear identification mark and data from several systems can be combined and stored in one external hard drive as well. This external hard drive will be marked and identified for seizure purposes in the panchanama recorded and it is important to mention the data with the hash value specified in the panchnama. A working copy of the data is prepared and the same is used for analysis during the post search investigations. It is to be noted that the imaged data has to be converted into a readable form through extraction by the forensic experts before they can be used by the Investigator. As regards the seized disk, the same has to be maintained for evidentiary purposes in case the data integrity is challenged subsequently in judicial or other forums.

3. **Preventing/ Tracking Data Manipulation during the Search:** Even in the normal software used for maintaining books of accounts, there is possibility of manipulation of the same during the course of the search. In case of tally accounting, remote access is possible and therefore, anybody having the access codes can alter the relevant data even though he is not in the premises. It is important therefore to disable remote access option whenever the books of accounts are found to be maintained in the tally system. In case of SAP system, it is important to have the audit trail obtained during the course of the search or subsequent to it as any alteration of the original entries are noted in the audit trail. These aspects have to be kept in mind by the investigator.

4. **Data Scanning:** The entire purpose of search and seizure operation is to gather useful evidence and in case of digital evidence, it is important to segregate what is useful from what is not. The digital data nowadays is voluminous and to scan the same for useful evidence is the primary exercise that an investigator has to do. The first step is to have a general look at the type of files which are contained in the system. It is possible to note whether there are a large number of excel files or document files or emails in the specific device. A cursory look is important to find out the general terminology that is used and the most common conversations or people interacted with. This helps in providing a lead to the possible keywords that are used by the assessee or the user and also indicates the persons with whom the conversations or transactions have happened. The next step in the same is the keyword search wherein the keywords are typed in and the files which contain those data are segregated. The keywords could be general in nature like “cash”, “cheque”, etc. as well as specific entities/ persons/ transactions. This is a case to case search and it is important to mention/ cull out the same from the prior analysis of the transactions. The files which are identified from this keyword search need to be examined in greater detail and if possible, completely covered. These

files could be copied to a usable device before the system is put to imaging so that relevant investigations can be carried out simultaneously.

The main purpose of study of accounts is to locate an unusual area. Examination of accounts is the weapon in the hands of the investigator to pierce the coating of the books entries hiding the concealed income.

4. APPLICATION OF FORENSIC ACCOUNTING FOR INVESTIGATION PURPOSE

Over a period of time, the scrutiny of assessment is becoming an exercise, where the assessing officer is hardly able to find time or able to investigate the accounts and business data of the assessee. The reason is due to the compatibility issues of digital formats in which the data exists, lack of tools/ resources, paucity of time and also lack of ability of the officers to use various analytical tools to investigate the accounts. As a department, we have a case to use computer aided investigation tool or forensic accounting tool to carry out investigation of accounts and business data at the time of scrutiny of cases for assessment and other investigations at the time of searches and survey actions. These tools also have good speed, high flexibility to operate, drill down facility to be able to view the underlying transactions, have compatibility with other databases and uses of apt graphics to draw inferences.

4.1 About Data Analytics

Data Analytics (DA) provides a structured framework for performing organized, efficient and reliable investigations that meet or exceed professional standards. It's simple yet comprehensive methodology accommodating every aspect of data analysis from importing raw data to reporting actionable results. Delays can cost money, so finding cost-efficient ways to conduct Forensic investigations is critical. DA is designed to maximize the investigation coverage and revamp traditional techniques for a more sophisticated and forward-looking approach.

Key Feature Groups in Data Analytics

4.2 Import

Effortlessly helps you capture data from any database and/ or application in any format like spreadsheets, access databases, flat files, delimited data dumps, XML extracts, SAP exports, Print formats and Adobe PDF based System Generated Reports.

4.3 Extract

Extract tasks helps you narrow down your analysis and retrieve data that satisfies specific criteria. It helps reveal risky events and transactions that occurred after the year end cut-off date.

4.4 Explore

Explore tasks help you dwell into your data and spot oddities and outliers. Forecast and extrapolate with predictive analytic tasks.

4.5 Categorize

Categorize tasks help you uncover meaning in seemingly disparate data elements. Discover commonalities and anomalies by Aging. Stratify your data to create profiles and investigate deviations from expected trends.

4.6 Sample

When testing an entire population it is impractical or uneconomical to conduct tests of details and balances on the entire population. Sample tasks helps you estimate characteristics of the whole population based on incidence of errors on the statistically selected sample.

4.7 Export

The findings emerging from the use of Data Analytic Tools can be exported to commonly

collaborative formats like spreadsheet, text, PDF and access databases for further validation, review, investigation and action by the concerned stakeholders.

4.8 Benefits of using Data Analytics

By simplifying the workflow, Data Analytics increases the economy, efficiency and effectiveness of the investigation process and makes sense of it all for consistent, high-performance reviews.

4.9 Universal file Import

When the data comes from different assessee sources and in a variety of formats, data conversion can sometimes be a challenge. It effortlessly imports an infinite number of records from virtually any source with step-by-step assistance.

4.10 Organized Work

Keeps the investigation review working papers organized and easy to locate in an intuitive folder management system.

4.11 Analyse

When your job is to identify and analyse risk, 100% data coverage makes all the difference. Whether one is assessing abnormal transactions in the books of accounts, conducting revenue reviews or spotting potential fraud, it ensures complete visibility of and timely access to every transaction that affects the business. With a holistic view of data sets, one can quickly see the big picture, identify relationships and patterns, and explore transactional data in depth.

4.12 Automation of Tasks

Seamless automation of review tasks for enhanced project productivity. The graphical project trail is a time-saving automation engine that lets you save ad hoc tasks and complex repetitions as Macros that you can tweak and use.

4.13 Review and Report

Reporting and presenting your findings is one of the most important steps in the workflow. Flawless analytics are of little use if one can't communicate the results. Review and communicated actionable results with reports, charts, pivot tables and graphical audit trails.

4.14 Validate your Activity

Investigation steps are automatically validated with the graphical project overview. In a highly-regulated and data intensive environment, good record keeping is critical. But with so much to do and little time to do it, validating your review activity can be a daunting task. The interactive project trail, provides a graphical or tabular history of every action you performed on any database within an assessee environment. The process of validation is automatic, so there's no laborious reconstruction of chain of steps required. Simply export or print the overviews to make your review process more visible.

4.14.1 Case Studies Explained with Forensic Accounting Tool

There are some important data analytics tools which can be used by an investigator like IDEA, ACL or Activedata. In this write up IDEA Caseware u/s 10 version from CaseWare Analytics, Canada has been used to illustrate these case studies (Copyright - www.caseware.com and www.samaaudit.com).

Data to be obtained in an Electronic Format– Balance Sheet, Profit & Loss Statement, Notes to Accounts, Grouping Annexures, Trial Balance and Ledger Accounts in digital format. *The data can be in a variety of formats like spreadsheets, access databases, flat files, delimited data dumps, XML extracts, SAP exports, Print formats and Adobe PDF based System Generated Reports.*

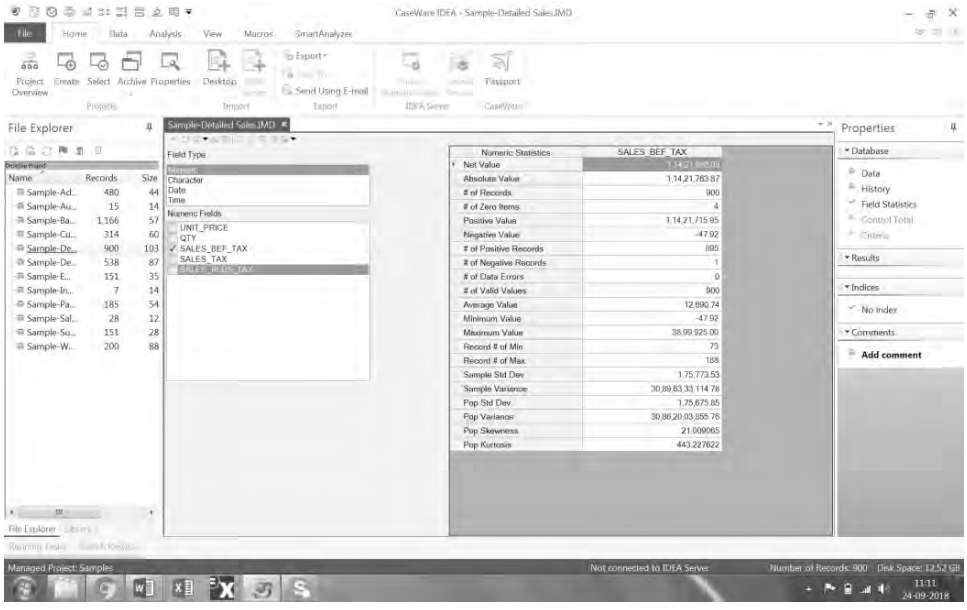
The findings emerging from the use of Data Analytic Tools can be exported to commonly

collaborative formats like spreadsheet, text, PDF and access databases for further validation, review, investigation and action by the concerned stakeholders.

The following key investigative tests can be used–

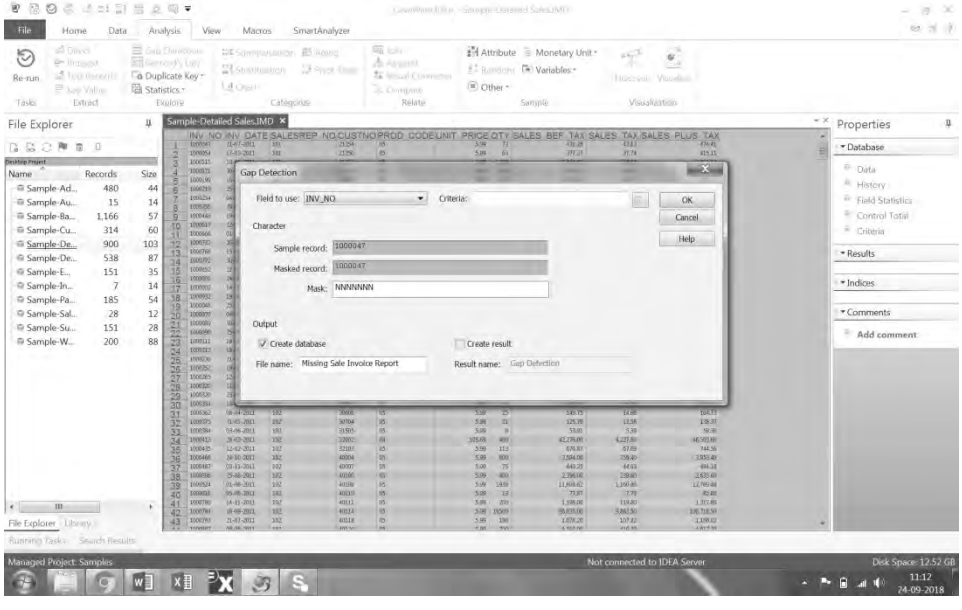
Getting business insights by investigating accounts from transactional level:

Field statistics function give details of the overall transactions, anomalies, Maximum, average and minimum values of transactions etc.



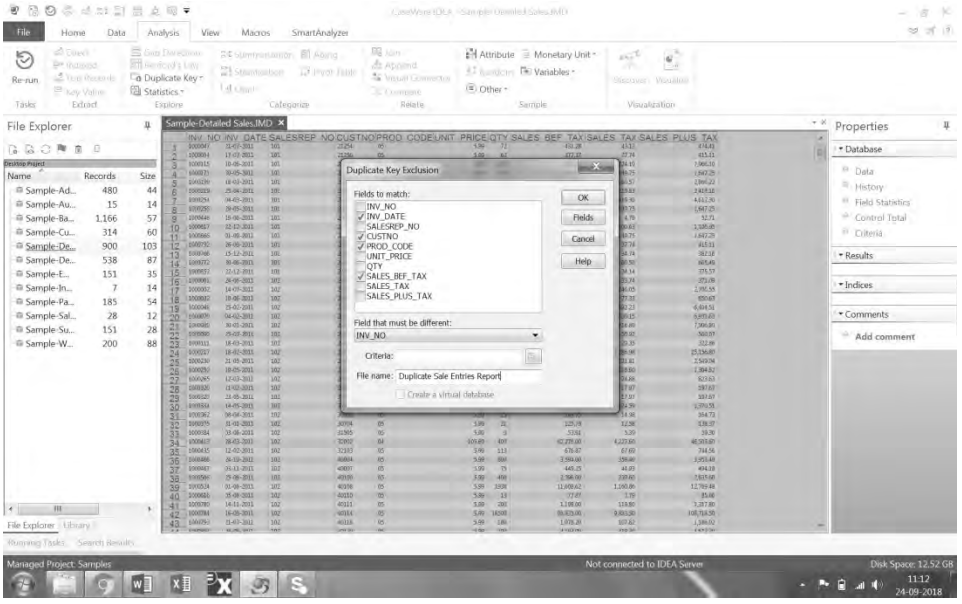
Accounting function tests helps in ascertaining nature and completeness of data–

Gap detection analysis–to know missing vouchers and may point to certain omission or manipulation

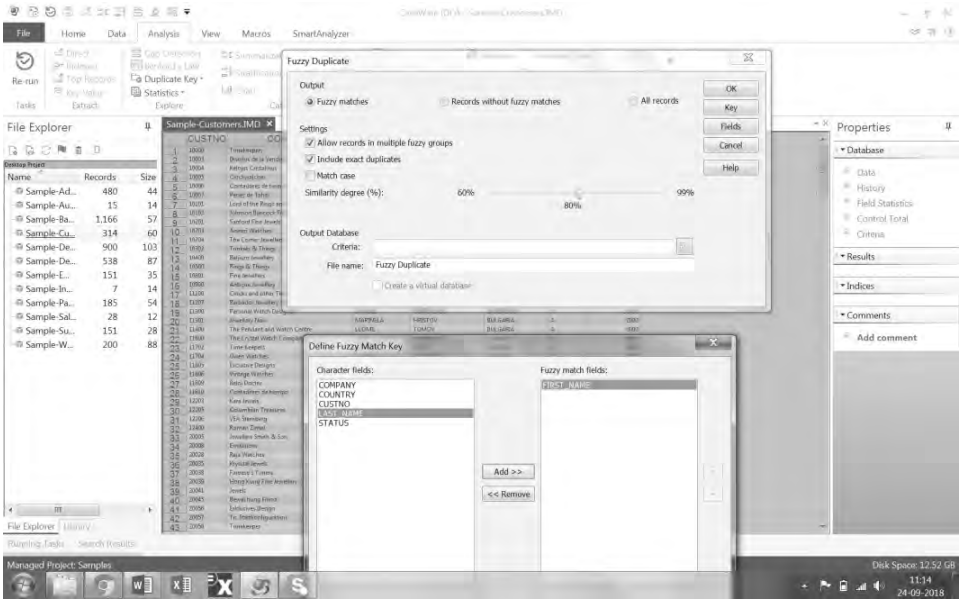


Duplicate entry tests–to know multiple entries on same date/ amount/ head of account and location–can be seen in sales or expenses related transactions

De-duplication–it helps in detecting transactions with same name of party with multiple accounts or same account in multiple names–concerns credibility of the account.

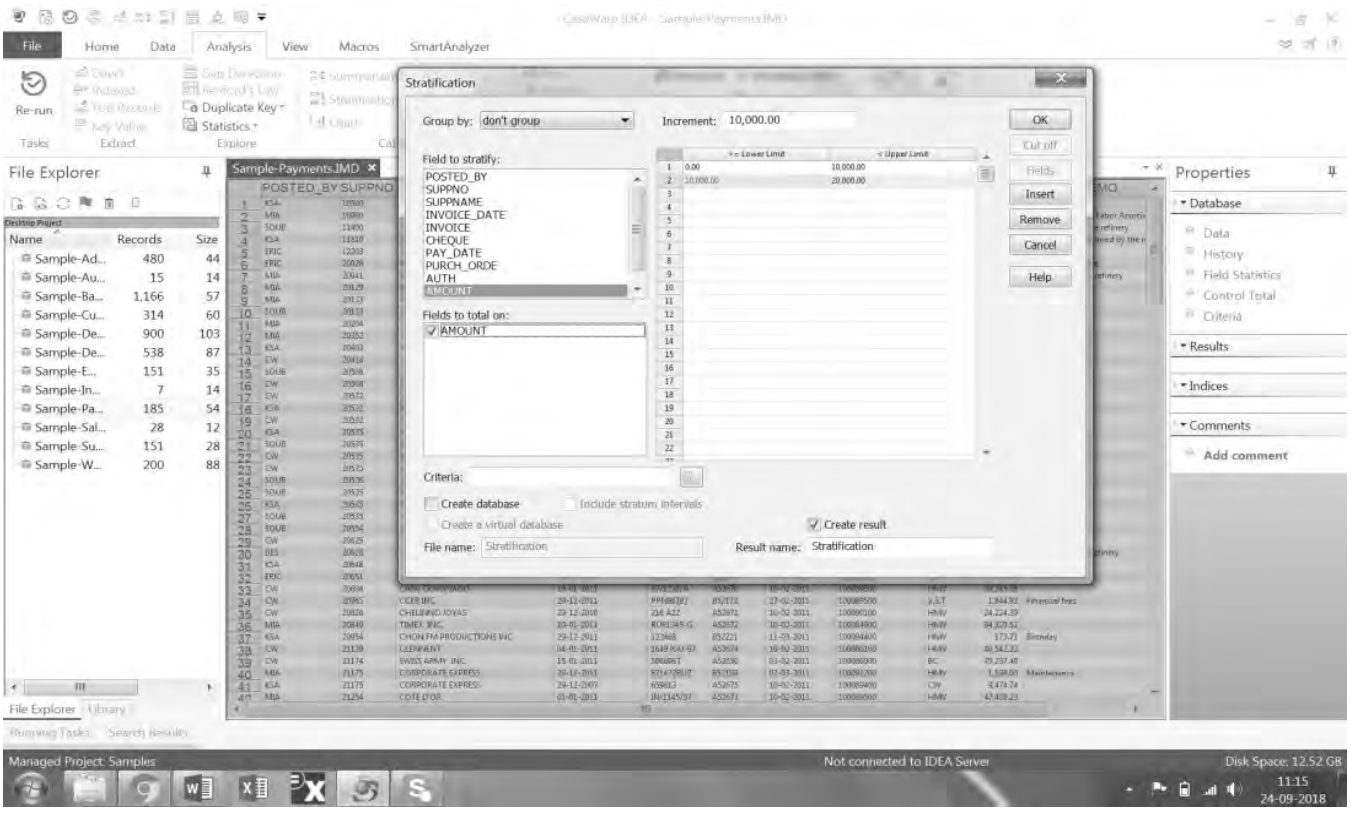


Fuzzy duplicate entry–to know entries with similar sounds or patterns in free text fields.

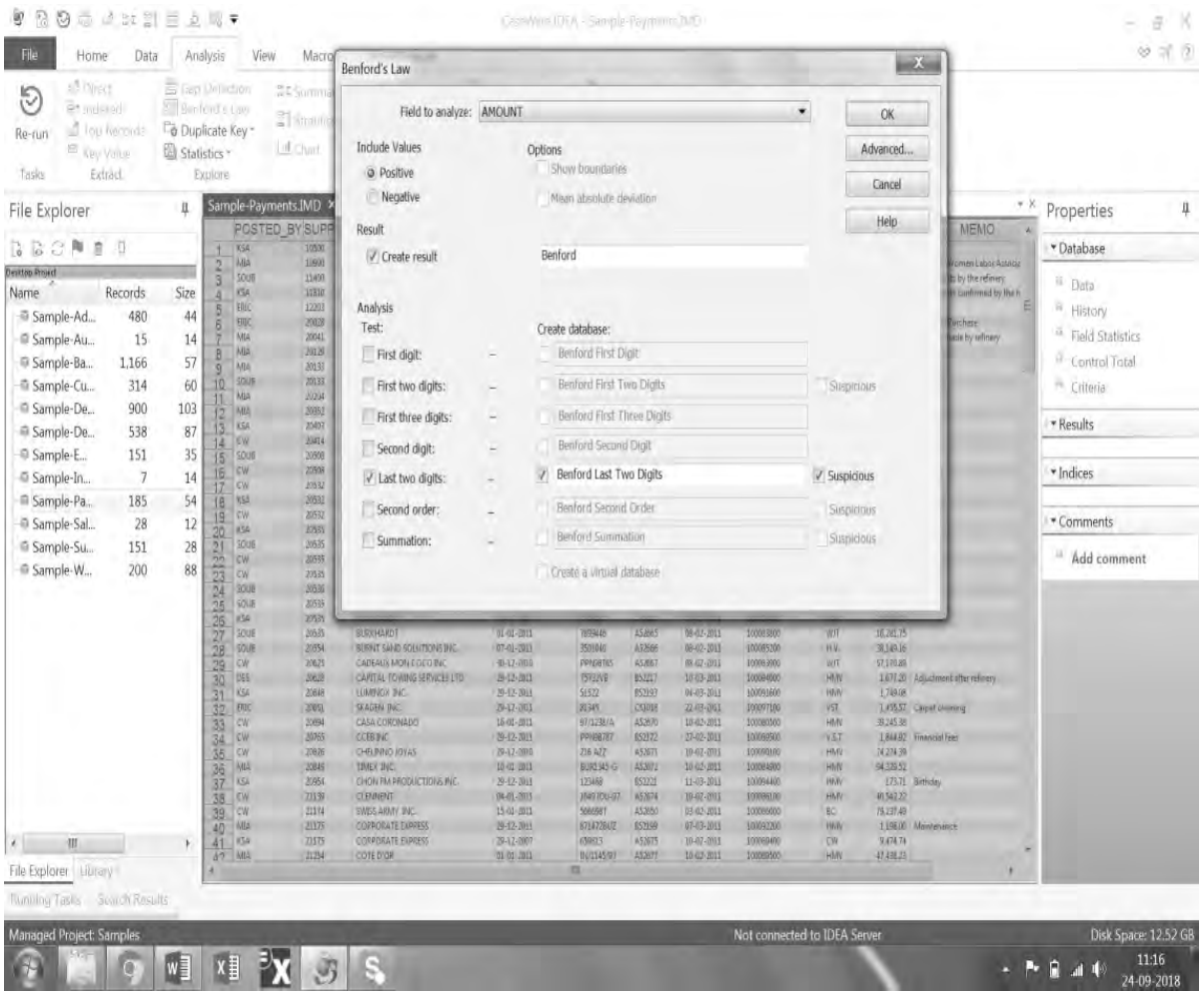


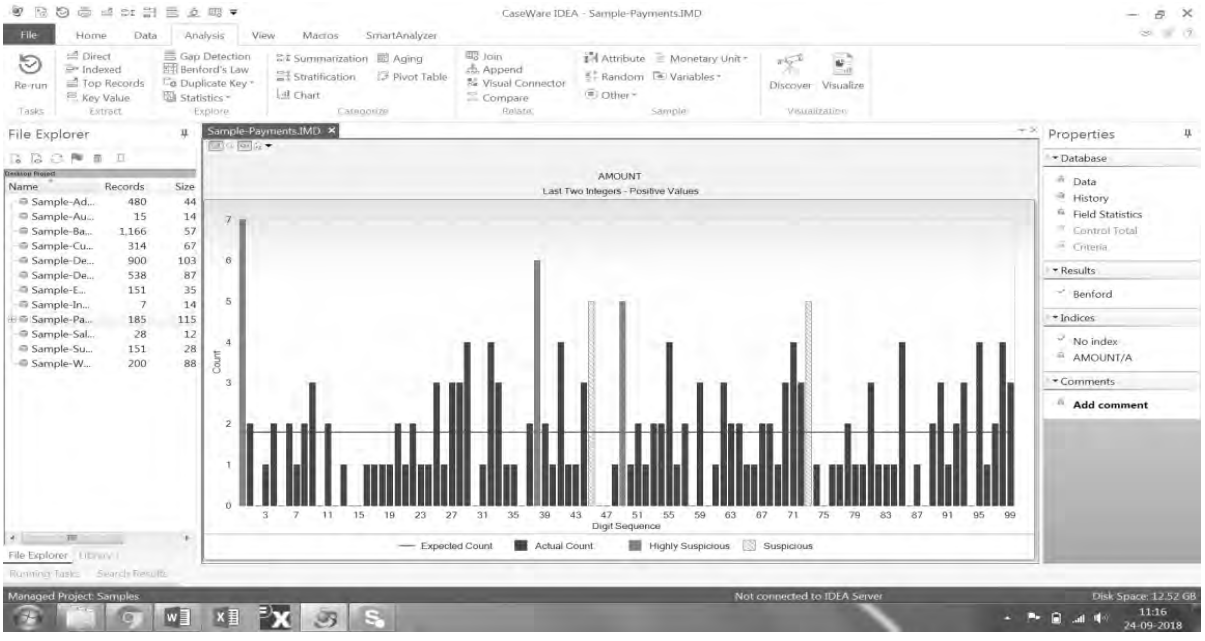
Pattern analysis–Using stratification function (layer) the transactions of vouchers can be arranged in terms of values and the overall pattern can be seen. It helps us to concentrate our efforts on high value transactions, which are limited in number but contribute to majority of transactions. IDEA has the feature of graphic depiction of such patterns, which is quite helpful to investigators.

Relative size factor tests–this tests helps in ascertaining the ratio between the transactions of same party and same product during a year and the deviations can be seen which indicate chances of accommodation or related party abnormal entries. This can be used for payments, purchases, receipts and payrolls etc.

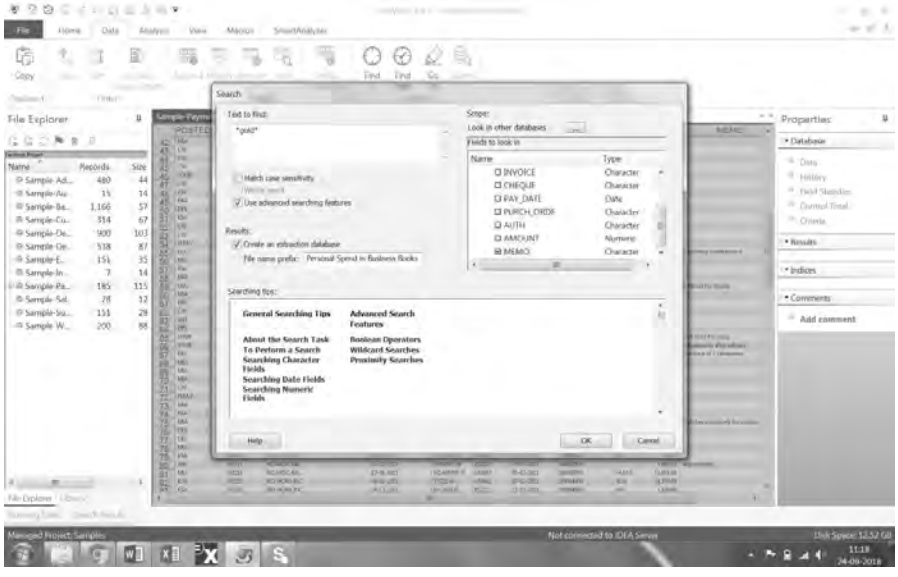


Benford's law–This test also helps in pointing towards deviations, manipulations, concealment, omissions, and artificial alterations in randomly generated transactions in any business. The deviation from the normal Benford pattern indicates this.

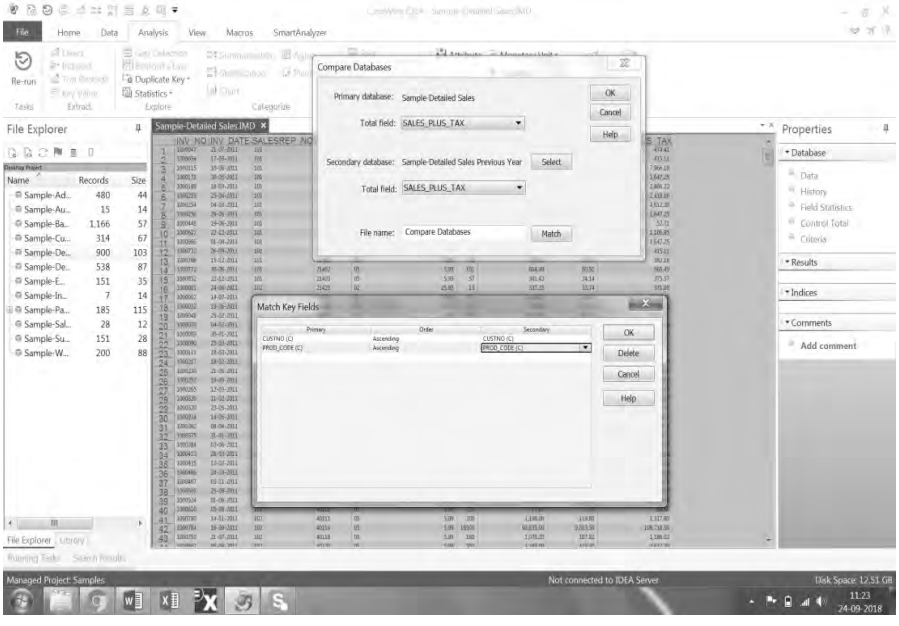

Benford's Law
Field to analyze: AMOUNT
OK
Advanced...
Cancel
Help
Include Values
Positive
Negative
Options
Show boundaries
Mean absolute deviation
Result
Create result
Benford
Analysis
Test:
Create database:
First digit:
First two digits:
First three digits:
Second digit:
Last two digits:
Second order:
Summation:
Benford First Digit
Benford First Two Digits
Benford First Three Digits
Benford Second Digit
Benford Last Two Digits
Benford Second Order
Benford Summation
Suspicious
Create a virtual database
File Explorer
Sample-Payments.IMD
Properties
Database
Results
Indices
Comments
Add comment
Managed Project: Samples
Not connected to IDEA Server
Disk Space: 12.52 GB


CaseWare IDEA - Sample-Payments.IMD
AMOUNT
Last Two Integers - Positive Values
Count
Digit Sequence
Expected Count
Actual Count
Highly Suspicious
Suspicious
File Explorer
Sample-Payments.IMD
Properties
Managed Project: Samples
Not connected to IDEA Server
Disk Space: 12.52 GB

Search for related party details in the Notes to Accounts and check completeness and accuracy of Related Party details in the Notes to Accounts vis-à-vis declarations made by the assessee and other intelligence gathered from Registrar of Companies, SEBI, Stock Exchanges Listing details etc. –the *SEARCH* function in IDEA is a powerful unstructured text based querying feature, which allows the user to look for specific Related Party name/s in the Notes to Accounts.

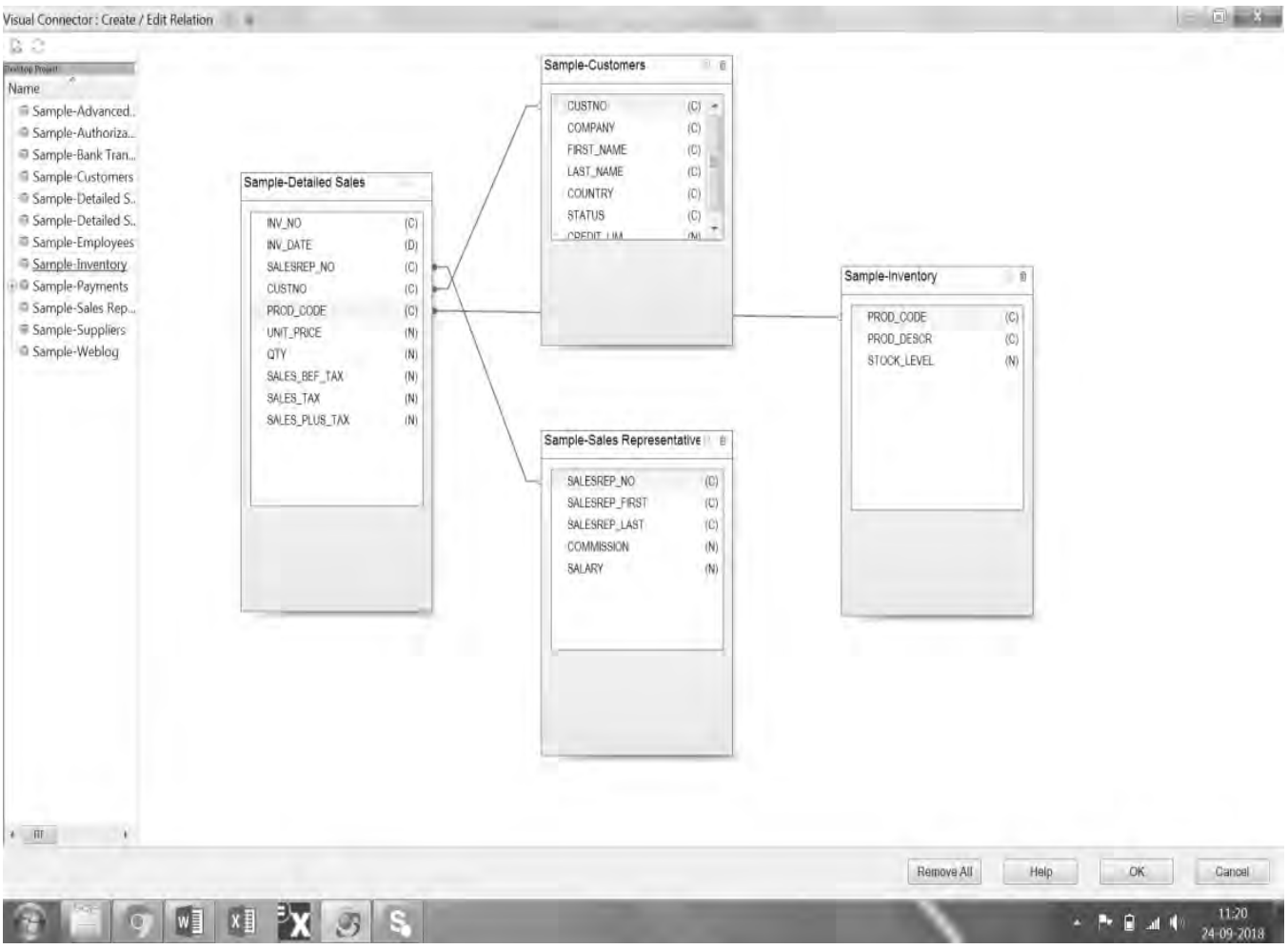


Check for the integrity of information provided in the Balance Sheet and Profit & Loss Account (Financial Statements) by reconciling the same with the Trial Balance–the *COMPARE* function in IDEA facilitates the user to summarize and match ledger accounts listed in the Trial Balance with Financial Statements and Grouping Schedules to identify mismatches in amounts as well as incorrect inclusions or exclusions from the Financial Statements and Grouping Schedules. Similarly inconsistencies between Trial balance and vouchers can be made out, if transactional data is available.



Ascertain the accuracy of revenue represented in the Profit & Loss Account like Service Revenue vis-à-vis revenue reflected in the Form 26 AS PDF file online to check for short reporting– the *JOIN* function in IDEA enables the user to identify discrepancies in revenue reported in the Profit & Loss Account versus the Form 26 AS PDF file online.

Trend analysis of financial values reported in the Financial Statement for the previous year versus the current year to capture inconsistencies and/ or significant variations between correlated ledger accounts like an increase in service revenue but reduction in Goods Service Tax (GST) levied across the two periods or increase in sales across two periods with an increase in stock on hand–the *VISUAL CONNECTOR* and *FIELD MANIPULATION* feature combination in IDEA helps the user graphically link the Financial Statements for the two periods and arrive at differences in key Income, Expenditure, Asset and Liability heads.



Some other areas which can be investigated using IDEA Software

S. No.	Area for Review	Data to be Obtained	Brief Steps in IDEA
1	Nexus between buyer and seller (same bank account, pin code, landline number etc.)	• Customer Master File • Vendor Master File	Join the Customer Master File and Vendor Master File on matching key field ~ Bank Account or GST Number or PAN Number to establish a nexus which can then be validated for possible collusion.
2	Purchase of items at a rate different than the market price for the items.	• Purchase Ledger • Market Rate Product Master List	Visual Connect the Purchase Ledger with the Market Rate List File on the basis of matching key field ~ Material Code to get the Actual Rate *vs.* Market Rate together and then extract for significant plus variances to be validated for possible artificial price inflation.
3	Non deduction of TDS on Interest, Commission, Brokerage, Rent, Royalty etc. –disallowable business expense.	• TDS Ledgers	Perform a Key Value Extraction on the TDS Ledger to identify and extract blank TDS Deducted Amount for each Head of Account like Brokerage, Rent & Consulting Charges into separate files for validation for omission in deductions.
4	Cash payments above the threshold limit–disallow ability test.	• Cash Book	First carry out a Summarization on the Cash Book to identify total Cash Payments per Head of Account per Date. Then extract Sum of such Payments about the threshold limit which qualify for disallow ability.
5	Assets capitalized within 180 days of financial year end but depreciation charged at more than 50%	• Fixed Assets Register	At the outset using Field Manipulation identify the Capitalization Days by arriving at the difference in Year End Date and Capitalization Date. Then look for Depreciation erroneously applied at more than 50% using Direct Extraction.
6	Depreciation allowed on assets not put to use.	• Fixed Assets Register • Current Physical Verification Listing of Fixed Asset	Join the Fixed Assets Register with the Current Physical Verification Listing of Fixed Assets on the matching key field 'Unique Asset Identification Number' to identify Assets physically available but not put to use on which Depreciation has been levied in the Fixed Assets Register.
7	Loan given in cash above the threshold specified limit.	• Unsecured Loans Ledger	Perform an Indexed Extraction to identify Unsecured Loans given above a particular value threshold in contravention of the income-tax Act and Rules.
8	Expenses of capital nature allowed as revenue expenses–search on key words in the narration according to the business of the assessee.	• General Ledger/ Day Book	Apply the 'Wild-Card' Search function in IDEA to look for Narration or Head of Account Description or any other Character Text Field in the General Ledger containing words like 'Machine', 'Hardware' etc., which are Capital in nature and should not be expensed out as Revenue in violation of the income-tax Act and Rules.

S. No.	Area for Review	Data to be Obtained	Brief Steps in IDEA
9	Expenses of personal nature allowed as revenue expenses–search on key words in the narration according to the business of the assesse.	• General Ledger/ Day Book	Apply the 'Wild-Card' Search function in IDEA to look for Narration or Head of Account Description or any other Character Text Field in the General Ledger containing words resembling spends of a personal nature like 'Jewellery', 'Holiday' etc., which are Personal in nature and should not be expensed out as Allowable Business Expenses in violation of the income-tax Act and Rules.
10	Ante-dating loans from banks to cover cash deficits	• Bank Book	Using the Direct Extraction and suitable criteria with filters within IDEA to extract loans from banks–ante-dated where balances just before receipt of Loans were in negative in the Bank Book.
11	Delay in payment of statutory dues	• Statutory Dues Ledgers	Join the individual Statutory Dues Ledgers with the Due Date for each compliance cycle using the matching key field 'Month' to get Actual Date of Payment with Due Date side by side for comparison to look for delays and subsequent non-compliances.
12	Capture details of any penalties or fines incurred in the books of accounts–search on narration field–disallow ability test.	• General Ledger/ Day Book	Apply the 'Wild-Card' Search function in IDEA to look for Narration or Head of Account Description or any other Character Text Field in the General Ledger containing words resembling Penalties & Fines like 'Penal', 'Fine' etc., which are non-Allowable Business Expenses in violation of the income-tax Act and Rules.
13	Variation in production expenses vis-à-vis production.	• Production–Actual File • Production Bill of Material	Link the Actual Production File with the Bill of Materials Standard Master Listing on the unique key field - Material Code or Batch Code or Process Code. This will get the Actual Input by the side of the Standard Input to Output Ratio. By appending a new field the Standard Output for the Actual Input can be computed through the Equation Editor in IDEA to identify excess or shortfalls in Standard *vs.* Actual for validation and investigation for bogus receipt or consumption entries inserted into the process.
14	Bad Debts written off against a specified Debtors, but not taken to income against the same Debtor in the last year.	• Bad Debts Write Off for Current Year • Debtor Listing for Previous Year	Match the Bad Debts Write Off Ledger for the Current Year with the Active Debtors Listing for the Previous Year on the basis of the matching key field 'Debtor Number' to look for Bad Debt adjustments done in the Current Year which are not part of the Debtors Listing for the Previous Year.

CHAPTER

6

Trading Account

1. The trading account in the simplest form reflects the results of the trading activity for a given period. It is prepared by following either of the two methods of accountancy, recognised *u/s* 145 of the Act, namely, "Cash system" or "Mercantile system". In the cash system of accountancy, entries are made only when cash is actually received or disbursed. Profits and losses under such a system are generally worked out on comparing the actual receipts with actual disbursements. Credit sales and purchases will not be reflected in the Trading account maintained on cash basis. In Mercantile system of accountancy, entries are made as soon as right to receive or liability to pay an amount arises, irrespective of the point of time when actual receipts/ disbursements take place. After the amendment to Section 145 of the Act, hybrid system of accountancy is no more an acceptable system.

2. OPENING STOCK

2.1 Closing stock of the preceding year becomes the opening stock of the current year. The quantity and value of the closing stock of preceding year should be compared with the corresponding figures in opening stock of the year. In case of any difference, necessary correction shall be made to the Trading account of the current year, if no plausible explanation is available with the assessee.

3. PURCHASES

3.1 Large concerns generally maintain records of purchases in separate "Purchase Book", "Jama Nondh" or "Jama Bahi". This is a subsidiary book and entries are made from this in the Ledger, debiting goods account and crediting the suppliers' accounts. Any over-statement or inflation of purchases directly goes to reduce the gross profits. Therefore, in any serious investigation, purchases need to be thoroughly verified.

3.2 Verification of Purchase Vouchers: Entries of purchases debited in the books of account should be checked with reference to the purchase vouchers. Unvouched or unsatisfactorily vouched purchases should be identified. In general, the purchases made in the black market would not be supported by proper vouchers. Instances are not uncommon, where unscrupulous assessees themselves get fictitious purchase vouchers printed, and present them

as genuine. It is not necessary that purchase vouchers written neatly on printed stationery, with letter heads, telephone numbers and Sales Tax registration numbers, would be genuine. More often they are, but this very presumption is sometimes utilised by such assessees to camouflage their bogus purchases. Doubtful purchase vouchers should be carefully scrutinized so as to find indications of spuriousness. The AO should have an eye for the odd or unfamiliar, e.g. unusual names of suppliers or an unusual area for supply of a particular commodity, large cash purchases, substantial purchases made in rising markets, etc. Sometimes, the usual details like telephone number, telegraphic address, code used, full addresses etc. may be lacking on such vouchers; or vouchers allegedly issued by different suppliers, may have the same style of printing, fresh appearance, etc. In cases of fabricated vouchers, sometimes the assessee may commit a slip,by putting a back date. The date(s) mentioned in such purchase voucher(s) should be carefully checked. Once there is reasons to suspect a particular purchase, the AO must follow it up from every angle.

In one case, a full-fledged press was found to have been maintained by a group of assessees for printing bogus vouchers. In another case, it was seen that a voucher was purported to have been received from an outstation assessee. This voucher in usual course, ought to have been sent by post. The voucher, however, did not bear any impression of folding. The AO noticed this and retained the voucher in his custody. Later he examined the assessee and got his statement to the effect that the voucher was sent by post in an envelope. When asked to explain as to why the voucher did not bear impression of folding, the assessee had no alternative but to accept that the voucher was a bogus one. In yet another case, the assessee who was a manufacturer of dyes and starch, claimed to have purchased tapioca from numerous villages in a particular district. As the AO knew that this district was not a tapioca-growing area, he carried out local inquiries and was able to establish that the purchase vouchers were bogus and had been written up by the assessee's own employees. Clues such as these are results of close observation and would strike to the AO if and only if he is vigilant.

3.3 Verification with Suppliers: Names and addresses of all the persons from whom purchases exceeding a certain monetary limit, say Rs. 10,00,000/- have been made, should be called for. These can then be short-listed for detailed cross-verification and investigation.

3.4 Verification of Mode of Payment: Normally, major purchases are paid by cheques. Therefore, at times, the assessees show payment by cheques even in respect of bogus purchases, to give them a colour of genuineness. In such cases, it becomes necessary to follow up such cheque payments, to see whether they are genuine or not. Some cases have come to notice, where, after the AO obtained counter-foils of the discharged cheques from the banks, it was seen that the 'payees' endorsements on all the cheques were in the same handwriting, or the cheques were got encashed by some front-man of the assessee itself.

3.5 Bogus Purchase: Bogus purchases are those where no transaction has taken place, and fictitious amount has been debited as purchase. The quantity of goods mentioned in such bogus purchases debited in the accounts but not made in reality, would not be reflected in the quantity of sales. There would, therefore, be difficulty in preparing a quantitative tally. Besides, Gross profit percentage would also get affected. If any purchase is not at all accounted for in the sales and the closing stock, the presumption will be that it is fictitious. It would require to be totally added back to the profit. Some common methods of introducing bogus purchases are as under:

- It has been pointed out above that the quantitative account would not tally where there are bogus purchases. An intelligent manipulation to overcome this drawback was noticed in a case where there were bogus purchases and yet the quantity account tallied, because, there were bogus sales to the same extent, the assessee remaining content with the difference

debited ultimately to the trading account. The modus operandi was somewhat as follows: The assessee would be debiting purchases at the rate of Rs. 150 in a systematic manner and would be crediting his sales at the rate of Rs. 100 also in a systematic manner. The net effect of these transactions would be to understate his profits by Rs. 50. He would be in a position to emphasize the fact that he has a complete quantitative account in respect of his purchases and sales. However, if the AO. were to work upon the trading account assiduously and systematically, he would be in a position to dissect the account into two and establish the pattern of manipulation.

- Purchase account can be manipulated from the beginning of the accounting year by debiting bogus items. In large concerns practicing tax-evasion, such manipulations are resorted to in the main accounts maintained on day-to-day basis, as keeping a duplicate set of accounts, is fraught with grave risks to the management. Although final accounts are prepared at the end of the year, yet in order to keep effective control, businessmen work out profits at the end of fixed intervals, say, 3 to 6 months. Inflation in purchases is resorted to when the trend of profits is more than the expected results.
- Sometimes, bogus purchases are debited towards the end of the day more or less in a systematic manner. Thus, in the case of a sugar factory it was found that there were two or three doubtful entries of purchases every day. On investigation, it was noticed that these fictitious purchases were supposed to have been brought by the same lorry, the number whereof had appeared once earlier also on the same day, though it was physically impossible for the lorry to make two trips on the same day according to the distance involved. Thus, purchases made towards the end of the year would require a greater scrutiny.
- There may be instances of purchases in transit being debited to the account without being shown in the closing stock.
- An assessee firm was deriving income from manufacture and sale of artificial silk shawls, scarves and chadars on retail basis. Preliminary investigations of the trading account revealed that the gross profit rate disclosed was considerably lower than that disclosed in the past. Purchases made by the assessee during the relevant account year were scrutinized and it was found that, towards the end of the accounting year, the assessee has debited a sum of Rs. 61,000/- to the goods account representing the purchase of raw shawls from an outstation party. A copy of account of the said party in the assessee's books was obtained and it was found that the entire payment had been made by the assessee in cash and at short intervals and a sum of Rs. 51,000/- was paid within four days. Further scrutiny revealed that there was no valid receipt for the alleged payment of these amounts. The assessee did not even pay any interest for holding over the sum of Rs. 51,000/- for six months. These factors led the AO to suspect the alleged purchase as not genuine. A reference was made to the AO of the seller. It was found that, the party was non-existent. Inquiries from the Sales Tax authorities revealed that the Sales Tax registration number granted to the party had been cancelled. The assessee was asked to state the mode of transportation of the goods, and produce any octroi or freight receipt to establish the actual receipt of goods in his city. In response, the assessee produced two receipts issued by a local transport company. On verification of the receipts with the Goods Inward Register of the transport company, it was found that the entries had been interpolated in the books of the transport company. On reference to the octroi department, it was found that no such payment had been made to the octroi department. The trucks whose registration

numbers were mentioned in these receipts were found not to have passed through the octroi barrier on the relevant dates. Further investigations revealed that the alleged goods were neither booked at the station of dispatch nor received at the destination, and the assessee had fabricated evidence in connivance with the transport company to substantiate its claim.

3.6 Inflation of Purchases: Over-statement of purchases can also be resorted by inflating the rate or value of purchases made from genuine parties. For identifying such items, the suspected purchase transactions should be compared with other purchases on credit on or about the same date. If these purchases are duly accounted for in the sales and closing stock but the rates of such purchases are not at par with the credit purchases made at the same point of time, the purchase prices may have been inflated. Scrutiny of purchase journals may be made to find out whether the purchases have been inflated. If purchase prices are found to be inflated, the estimated inflation will have to be added to the book result. Proper facts should, however, be ascertained to enable one to draw definite and logical inferences as to inflation in price. Some of the methods employed for inflating purchases, are as under:

- Purchases from agriculturists are easy to be inflated because there is no practice of giving bills. Even if bills are given, they would only serve the assessee's case for creating evidence in his favour. For the agriculturist, it does not matter, as he is not liable to income-tax. Of late, there has been refinement of this old practice of not producing vouchers. Registers of purchases are maintained by the assessees, on which thumb impression of agriculturists are taken in evidence of their sales. Evidence such as this cannot easily be rejected by an AO. Such problems, however, can be tackled by a systematic and simultaneous study of the cases of a similar nature. Useful inferences can be drawn by comparing purchase rates of different assessees. Comparison should be made where facts are more or less similar and comparable. Reports of market committees established by the Government to safeguard the interests of agriculturists would also go a long way in helping the AO to judge the genuineness of such purchases.
- The assessee firms were dealers in betel nuts. Large purchases of betel-nuts were found recorded in their account books. Most of these purchases were shown to have been made from certain Calcutta parties. When the AO perused the invoices produced, his suspicion was aroused by the fact that several of these invoices did not bear the full address of the seller, such as door number, telephone no., telegraphic address etc., and by the further fact that the invoices revealed a striking similarity of typing. He therefore made detailed enquiries at Calcutta, which showed that, one of the alleged suppliers was nonexistent; some of the alleged suppliers had not sold any goods to the assessee firms; even those who had actually sold betel nuts to the assessee firms, had done so at a price far less than recorded in the assessee's books, and the invoices produced in the names of these Calcutta parties were fabricated by the assessee.

3.7 Over-Invoicing of Imports: Very often, importers resort to over-invoicing of imports from foreign countries against licences granted to them by the Government, with the following two motives:

- To accumulate foreign exchange outside India, and to utilise the same either for personal expenditure or for illegal business transactions including smuggling or to sell the same against rupees at black market rates in India to persons going abroad for their use outside India.
- To reduce their profits and tax liability in India by inflating the cost of their purchases.

The AOs dealing with cases of importers are advised to keep these factors in view, and make detailed inquiries in suitable cases. The approach

of inquiry will differ from case to case but the following general hints may be kept in mind:

- Inquiries may be made from the Enforcement Directorate and other agencies monitoring economic intelligence.
- In the cases of large/ suspicious imports, statements on oath/ affidavits of the Proprietor or Directors can be obtained to the effect that they have no account in any foreign banks either in their own names or in names of their wives, children, relatives or employees. This will facilitate their prosecution in case their statements are found incorrect, subsequently.
- For detecting whether there is any over-invoicing, the officers may make comparison of the cost of similar purchases made by other importers.
- In such cases, the assessee or the members of his family may be visiting foreign countries frequently, for pleasure, medical treatment, education etc. in the guise of business trips. A detailed probe should be made about their expenses on travel, stay education etc. Since the Reserve Bank issues only a limited foreign exchange, the balance of the foreign exchange required for such trips is often met from undisclosed sources.

3.8 Trade/ Cash Discounts: It is customary in most businesses to allow trade discounts and cash discounts. Trade discounts are generally allowed on catalogue prices. Cash discounts are allowed to give an incentive for prompt payments. These discounts vary from trade to trade and from place to place. It should be seen that such discounts are duly accounted for by the assessee. In case of trade discounts, it should be ensured that the price entered in the accounts is "net" and not "gross". Similarly it may also be seen that full credit for cash discount received has been given by the assessee.

3.9 Miscellaneous Matters: Purchases should also be checked with reference to direct expenses e.g. Cartage, Octroi and Railway freight etc. There can be cases where, though such expenses are debited to the Trading account, the corresponding purchases are not recorded in the account books at all to bring down the profits.

4. DIRECT EXPENSES

4.1 Only expenses of a direct nature can be debited to the Trading account. Most of these expenses can be verified from the bills/ vouchers/ notes maintained by the assessees. If purchases are from distant places, expenses on railway freight are likely to be considerable. On the other hand, if purchases are from nearby places, expenses on truck hire are likely to be more. If the purchases are local, more expenses on cartage and wages may be found. Unvouched, unexplained and unsatisfactorily vouched trading expenses may be singled out for further verification. The assessee should be asked to substantiate these by other evidence and if he is not able to do so, the suspected items can be disallowed. However, their reasonableness compared to volume of business done should be seen. The expenses should also be compared with the volume of business and if any sudden increase is noted, the reasons for the same should be inquired into. In some cases, there can be valid reasons for increase of expenses *viz.*, increase in railway freight, octroi duties etc. The explanations given by the assessee should be carefully scrutinized to see that there is no attempt to bring down profits by claiming bogus expenses.

5. SALES

5.1 Entries regarding sales are generally made in the Sales Book, "Nam Bahi" or "Nam Nondh". Normally, sales are supported by duplicates of cash memos or credit memos, and documents showing transport/ delivery of goods. If the turnover shows a substantial fall as compared to the preceding year, the assessee should be asked to explain this, and to establish the correctness of the explanation by appropriate evidence. The explanation and the evidence furnished in its support can be then put to proper examination. The bifurcation of sales, with reference to specific types of goods/ commodities, parties and periodic intervals (month wise, fortnight wise, etc), giving

quantities, rates and values, can be called and examined. Corresponding information given to other government departments, e.g. Sales tax, Excise, Imports Control authorities (for seeking import of raw material), can also be called for and compared with.

5.2 Understatement of Sales: Apart from the understatement of sales by suppression, sales are also understated by recording them at figures substantially lower than what they really fetch to the assessee.

- Such suppression is often resorted to through the nominees or benamidars, sometimes a chain of them, so that the difference between the price accounted for in the books of the assessee and the price charged to the ultimate purchaser comes back to the assessee. An intelligent study of the customer's list may reveal names, the sales to whom would call for thorough probe both in regard to the bona fide of the sales as also the independent standing of the parties concerned.
- In one instance, a certain mill imported 51,082 kgs. of nylon yarn known as 'Bayer Parlon', for the specific purpose of manufacture of mixed fabrics meant for export. The assessee, in contravention of the conditions for the grant of license, sold the imported yarn at a flat rate of Rs. 54/- per kg. against the market value of Rs. 100/- per kg. When questioned about the low sale price as compared to the market value, the assessee explained that the yarn was deteriorating day by day, and that, since the bank was pressing hard for the repayment of the loan, the yarn was sold at a low price. The AO, after enquiry, found that either the purchasers were not traceable, or the purchasers admitted that they were only intermediaries whose names were brought in by paying them a nominal commission. Some of them even admitted that they did not have the means to make purchases, and that the delivery of goods was taken directly by the real purchasers. The assessee was not able to establish the identity and whereabouts of the real purchasers. Some of the ultimate purchasers of the nylon yarn, when contacted by the AO, admitted that the nylon yarn was in good condition and that the price paid by them was between Rs. 103/- to Rs. 104/- per kg.
- The rates of cash sales should be verified with those of credit sales. If large quantities are sold in cash to one individual on the same day or from time to time, and the rates of such cash sales are unduly lower than those of credit sales effected concurrently, an understatement of sale proceeds may be suspected.
- In some commodities there may sometimes be volatile fluctuations in price and an assessee having substantial stocks of the particular commodity at that point of time will have substantial profit or loss on this account. If there is a loss this will of course be left undisturbed. If there is a profit there may be a tendency to manipulate. For instance, when there is a substantial increase in the excise duty of sugar, the market price of sugar will correspondingly increase and any dealer having large quantity of sugar on hand will have an extra profit to that extent. If the assessee wants to suppress this profit, attempt may be made to show fictitious sales at a prior date at the previous deflated prices. Even the sugar in transit may be shown as sold. On such occasions if there are any abnormal sales on the few days preceding the price increase, the genuineness of the sales will require critical examination.
- Sometimes assessee may show disposal of large stocks when the market is falling. If the AO. has a clear idea of the condition of the business during the previous year, he may be able to locate bulk sales made at lower rates in a falling market. In such cases, he may select some of such sales for proper scrutiny to see whether the assessee has not suppressed sales by taking advantage of the fluctuating condition of the market during

the previous year. Where particular trades have shown sharp fluctuations during the previous year, this approach may help the AO to locate manipulated entries.

- In seasonal businesses, which flourish at a particular time of the year, the volume of business shown at those times may be usefully compared with the business reflected in the account books at other times. For instance, sales of woolen cloth would rise in winter and cotton goods in summer; the receipts of a goldsmith would go up in marriage and festival seasons. At such times, sales of those particular commodities ought to be more than at other parts of the year. Similarly, purchases of grains and tobacco which may be seasonal may be more at that particular time of the year. What is required to be broadly noticed is whether the rise and fall in the volume of business during the year is such as may be regarded as 'normal' with the business. If not, the account should be carefully investigated.
- Payments for sales made to bona fide parties are usually received through cheques. It is possible that such cheques may not be credited to the sales account but to some personal accounts. Subsequently such accounts may be squared up by showing cash withdrawals. In case the drawer of the cheque is a person other than the person in whose name the account stands, the credit appearing in the account should be subjected to scrutiny.

5.3 Mode of Payment: If the sales are suspected to have been under-billed, apart from checking the books of account of the other party, the mode of payment should also be checked. If it is by bank drafts or telegraphic transfers, enquiries should be made whether the purchaser made any further transfers of funds on that date. It is possible that on-money might have been remitted by a separate demand draft or telegraphic transfer. The destination of the remittances on the same day should, therefore, be carefully checked. Similarly, if a railway receipt is sent through a bank, the assessee might have made two remittances instead of one, the second one representing the on-money. Here also, a similar check should be exercised.

5.4 Sales at Lower Rates to Nominees: Sometimes there is diversion of sale by showing the sale to a nominee at a lower rate. The nominee then sells the goods to bona fide customers either directly or through a chain of other nominees. The total profits are thus distributed between the assessee and the various nominees in order to reduce the incidence of taxation. In large number of cases, voluntary returns are also filed to get these nominees assessed in order to show that they are genuine traders.

5.5 Sales to a Fictitious and Non-Existent Concern: In one case, the assessee company 'X' floated a *benami* concern 'Y' to whom all its cotton waste was shown as being sold. On scrutiny it was found that the sale to 'Y' were made at rates much below the market price. The firm had been assessed to income-tax and registration had been granted. On a reference to that file it was noticed that the signatures on the partnership deed were different from the signatures on the application for registration and the return was purported to have been submitted by a partner 'Z'. Local enquiries, however, revealed that such a person never existed. It was also seen that 'Y' had no finances of its own and the assessee company itself had advanced substantial amounts to 'Y' and all the sales were made on credit without receiving either a deposit or an advance - contrary to normal market practice. 'X' had also advanced moneys in the name of the non-existent partner 'Z' without any security or without any interest. The examination of the books of account of this firm revealed that the purchases from the assessee company and sales to the other parties had generally been made on the same dates. This showed that this firm had never taken delivery of cotton waste and the goods were delivered to the other parties only. But the bills were made by the company first in the name of the firm who made the bills in the name of the other parties so that profits could be transferred to 'Y'. On a detailed scrutiny of the books of 'Y' it was found that there were omissions of certain purchases

in the purchase journal, and yet the totals tallied with purchases from 'X' (assessee company). Similarly, some goods were shown as sold, even before these were purchased. This indicated that the books had been written on a later date. As a result of investigation, substantial amounts were added in this assessment.

5.6 Suppression of Sales by Companies: Where the assessee is a company, a question may arise as to whether the profits shown as having been made by the benamidar really belong to the company itself, or to persons in control of the company's affairs. In one case, the assessee company was engaged in the business of manufacture and sale of yarn. It was found that, out of total sales for Rs. 41,50,209/-, sales to the extent of Rs. 17,19,624/- had been made to three parties closely connected with the managing agents, at prices considerably below the market rates prevailing on the dates of the transactions. An explanation was offered before the AO that the sales were effected in pursuance of oral contracts entered into earlier and that the prices fixed were in accordance with those prevailing on the date of contract. The AO rejected the explanation as false and the finding was confirmed by the Tribunal - and not disturbed by the High Court. At the same the addition of Rs. 1,46,000/- to the total income of the Company on the basis of the difference between the sale price and the market values was not upheld by the High Court. The Hon'ble Court pointed out that, the rejection of the assessee's explanation gave rise to three different positions with different legal consequences as below:

a. Where the sales to the alleged intermediary are bogus, with the result that no title was intended to pass from the company to the intermediary, i.e. the alleged purchaser; the addition could be made on the basis of the prices realised by this intermediary on sale to the real customer;

b. Where the actual sale price realised has been understated by a false entry of lower figures in the Company's books, an addition could be made to bring the value of sales to the correct figure;

c. Where the sale has been effected by the Managing agents of the company at below market price for improperly benefiting themselves or their friends, the act would no doubt be a gross fraud on the part of the Managing agents and even the company might have a right to proceed against its directors or Managing Agents for reimbursement of the losses caused to it; however, there is a real sale to the purchaser and the benefit which the purchaser derives in the shape of concessional sale cannot be regarded as a profit of the Company on which it can be taxed.

The Board have issued instructions to the effect that when an AO comes across any sales at grossly inadequate values, he should pursue the transaction in the books of the purchaser and come to a definite finding in the light of all available material as to which of the situations in (a), (b) or (c) above, describes the case. It has to be noted that only in cases covered by (a) or (b) above, an addition to the income of the company can be sustained. In an exceptional case where there is reasonable doubt as to whether the case is governed by (c) or by either (a) or (b), assessments should be made in the hands of the company as well as of the purchaser, one assessment being regarded as a protective assessment.

5.7 Verification with Contract Notes: In large income cases, the AO would do well to verify the purchases and sales transactions with the contracts entered into for those transactions. There have been cases where deliberate attempts were made to alter the rates in the sale contracts when the prices were soaring.

In one case, the assessee, a member of the East India Jute and Hessian Exchange Limited, carried on business in Hessian and gunny, and speculation in gunny brokerage. Scrutiny of the documents seized during a search operation revealed that the assessee was entering into bogus transactions in its account books in order to under-state its assessable income and in the process had fabricated various contract documents as under:

*There was a transferable specific delivery contract of sale by the assessee to M/s "XY", a close ally of the assessee firm. This was found to be fake because there was no registration mark on the back of the contract documents as required by the bye-laws and forward contract regulations of the East India Jute and Hessian Exchange Limited.

*The signature on the contract document, ostensibly of a licenced broker appeared to be that of one of the partners of the assessee firm itself. In the buyer's copy of the contract impounded form M/s "XY", the adhesive stamp appeared to be distorted, and on the reverse of the document, in place of the usual rubber stamp of East India Jute and Hessian Exchange Ltd., there was insertion of a registration number in ink, which was unusual and abnormal. On checking with the books of the Exchange, the registration number was found to belong to a different contract between two entirely different parties.

*Two other contracts were also found to be fake. In both the contracts, 'A' had been originally shown as the buyer, but by means of an entry interpolated under the signature of one of the partners of the assessee firm, the latter's name was inserted. On examination of the books of the Exchange it was found that these contracts were between entirely different parties.

*A number of blank letter-heads of certain collaborators were found in the assessee's possession. The assessee used to insert therein settlements by way of differences as and when necessary.

An assessee having large profits was found to have wiped off a considerable portion of such profits from the books through ante-dated false transactions shown as entered into by the assessee with some selected brokers. The brokers first received from the assessee the profits arising out of the fictitious transactions. Thereafter, by similar bogus transactions and 'difference' bills, they took out the profits from their books and returned the same in cash to the assessee or his nominees. A number of persons were brought in to give the transactions a colour of genuineness.

5.8 Fictitious Sales: Sometimes entirely fictitious sales may be entered in the books, to obtain various benefits in an illegal manner, e.g.;

- Where the assessee gets import licences, which fetch high premium and are sold outright in the market, it may be advantageous to record entries showing as if he had imported the goods and sold them. Therefore, in cases where the assessee is suspected to have misused his import licences, the destination of the goods, as stated to have been sold by the assessee, should be checked up. The AO could find several small clues here and there. He should see whether transport charges claimed were really paid or not, and whether the goods supposed to have been brought into the godown and then sent out to some other person, were really transported or not. Enquiries can be made with the Railway or the transport company that is supposed to have carried the goods, and also with the octroi authorities on the way. The books of account of the so-called purchaser should also be checked.

- Fictitious entries of sales may also be made when, the assessee is in immediate need of cash to discharge his recorded obligations but the cash recorded in the cash book is insufficient for that purpose. On such occasions, he will show fictitious cash sales in his books to make it appear that he had sufficient cash. Needless to add, he is thereby introducing his unaccounted money in the books in the guise of sales proceeds. In appropriate cases, therefore, all the aspects of the sales such as the movement of goods, payment of sales tax, and the movement of money must be examined critically.

5.9 Miscellaneous: Sales of miscellaneous by-products of the business eg., wastages, spillages, rejections, packing materials, gunny bags, etc., are often either omitted or understated.

6. CLOSING STOCK

6.1 Manipulation of closing stock, both in terms of quantity, and value, is the most common method of understating profit. It is therefore necessary to ascertain the method of valuation of closing stock, i.e., cost or market price, or the lower of the two, being followed by the assessee, and to obtain a complete commodity-wise, item-wise and quantity-wise inventory of closing stock, duly certified by partners/ Directors. It can then be checked whether the assessee has shown sales of any particular item in the beginning of the next year which does not appear in the closing stock for the year under consideration, and for which no purchases have been made up to the date of sale in the next year. It can also be checked whether the purchases of the last few days of the accounting period are reflected in the closing stock or are covered by sales before the closing date.

6.2 Conversely, sales of first month of the next year should be studied with reference to the purchase of first month of the next year. It may happen that sale in first month of the next year may be more than the opening stock + purchase of the New Year. This technique is especially useful for examining the adequacy of the work-in-progress in the hands of a contractor. Contractors often receive contract payments in the first two/ three months of the following year, without incurring corresponding expenditure on contract in those months. The surplus invariably represents receipts in respect of opening work-in-progress (WIP) of the new year which ought to be in the closing WIP of the year under examination.

6.3 The closing stock can also be checked with reference to availability of storage space. If the assessee hires new godown, the stock should normally be higher. Similarly, closing stock can also be examined with reference to fire/ theft insurance policy for loss of stock.

6.4 Suppression of Closing Stock

6.4.1 Goods in Transit and Paid for: The physical inventory of stocks as well as the stock register, if any, may not record the goods paid for and debited to purchase which are still in transit, and have not reached the assessee's business premises. By scrutinising the purchases account such items should be located.

6.4.2 Goods Sent to Customers for Approval: It may be verified that goods sent to customers on approval have been included in the closing stock.

6.4.3 Closing Stock at Branches: It should be checked whether closing stock at the branches have been properly included.

6.5 Under-valuation of Closing Stock: Some of the common method for understating the value of closing stock are as under:

Under-valuing closing stock by showing GP rate at pre-determined rate, and showing closing stock as balancing figure. Where GP rate is exactly identical over several years, this mode of under valuing stock should be strongly suspected.

Under-valuing closing stocks of higher quality, by applying to these, the rate for inferior quality stocks. This is very common in cases where quality-wise stock details are not maintained. e.g. in cotton business where quality of cotton is very important, or in bullion business where purity of gold is very important.

Under-valuing closing stock by mis-referring the purchase bill where the stock is valued at cost, or obtaining make-believe purchase bills to lower the valuation.

Under-valuing closing stock by mis-referring the sale bill where stock is valued at market rate or obtaining make-believe sale bills to lower market value.

Under-valuing closing stock on the basis of purchase bills without adding some or all the direct expenses and/ or taxes, e.g. excise, custom, octroi etc, to such purchases.

Under-valuing closing stock by taking average purchase cost or by valuing it on the basis of Last In First Out method (LIFO).

Under-valuation of closing work-in-progress, by excluding various direct expenses.

- Omitting to include the stocks sent on consignment, or lying in transport depot, or sent for approval of customers.
- Omitting to include the stock purchased under bogus consignment arrangement e.g., stock received with builty/ Railway receipt in the name of self.

Under-statement of closing stock of bardan, gunny bags etc.

Under-statement of closing stock by showing weight loss.

- Under-statement of stock by applying wholesale rates by a retailer valuing stock at market rate. If the assessee is a retailer, then only retail rates should be applied to get the market value of closing stock.

6.6 Overstatement of Closing Stock: In certain situations, it may be advantageous for the assessee to overstate its closing stock, e.g.-

In the last year of eligibility for deduction u/s 80IA of the Act, it may be in the assessee's interest to overstate its closing stock and profits;

In cases where the assessee is getting deduction u/s 80 HHC, but has only a few export orders for the next year;

In cases where the assessee has large brought forward loss/ depreciation etc, which is likely to lapse.

In such circumstances, the duty of the AO is to ensure that the value of closing stock is correctly worked out, in accordance with the method of valuation of stock regularly followed, and the quantity tally of the closing stock. This may also require re-computation of gross profit, and admissible deductions u/s 80IA, 80 HHC, etc.

7. QUANTITATIVE DETAILS–STOCK REGISTER

7.1 In analysing the gross profit rates, one is concerned with the values of the goods dealt with in a trading account. At the same time, trading account should be examined to see if it is supported by a quantitative tally. In the cases of large concerns doing business on wholesale basis or even in case of big retailers, quantitative details should be insisted upon to check the accuracy of purchases and sales. Such businessmen generally keep regular stock tallies or registers and these should be checked to ensure that all purchases have been duly accounted for. If such a tally is not forthcoming and the gross profit shown is not in sync with the normal trends of the year, there will be reasons to presume that the result of the Trading account is not reliable, and a more thorough examination will be necessary.

7.2 Quantitative accounts are sometimes available in the trading account itself, the quantities being specified against opening and closing stock, purchases and sales; but mostly, trading accounts contain the values, the quantities being recorded in a separate stock register. The importance of stock register for establishing reliability of the disclosed trading results, has been accepted in various judicial pronouncements. Whether the absence of a stock register is material or not for concluding that income, profits and gains cannot be properly deduced from the account books, depends upon the circumstances of the case and the material gathered by the AO.

7.3 Where a stock register is available, the correctness of the entries therein should be test-checked by picking up some purchases and sales and seeing whether these are entered correctly in terms of quantity, quality and date. There have been cases where on periodical stock-taking, sales have been found to exceed opening stocks and purchases up to the period when sales were being checked. If the stocks are not entered on correct dates, this will be a matter for investigation. Ordinarily, the dates of entry in the register should be the actual dates of physical receipts and delivery of the goods and not dates of purchases or sales invoices. Sometimes the transaction may be found entered on the dates of the purchase or sale bills; this by itself is not a defect. But if there is any reason to suspect the availability of goods for delivery on any date, the purchases should be examined critically to see what were the physical stocks on that particular date.

7.4 A comparison of stock shown in the books, with the particulars of stock pledged/ hypothecated with the bank, should always be made. The Supreme Court has, in the case of Dhansiram Agarwal (201 ITR 192, SC), held that, it is legally correct to make addition to the stocks on the basis of sworn statement of quantity of stock given by the assessee to the bank, and it is not permissible for the assessee to say that the statement given to bank was incorrect. Such comparisons should be made not only for the stock shown at the end of the year, but the stock shown to the bank at the end of every month, by obtaining month wise closing stock as per stock register. In suitable cases, the project reports submitted by the assessee to the bank/ financial institutions can help understand the nature of business and the earning potential correctly. In the project report, the borrower has to show the various sources of purchase of raw material, likely prices of purchases/ sales and estimated earning capacity. Therefore, financial viability studies made by financial institutions should be examined by the AO.

8. OTHER MANIPULATIONS IN TRADING ACCOUNTS

8.1 Some other modes of concealment with illustrations are given below:

- An assessee may reduce the totals of both the purchases and sales by an equal amount to disclose a higher Gross profit rate. In a case the trading account showed sales at Rs. 2,77,786/- purchases at Rs. 2,48,999/- and gross profit at Rs. 33,568- i.e. 12.09%. The correct totals of sales and purchases turned out to be Rs. 3,77,786/- (instead of Rs. 2,77,786/-) and Rs. 3,48,999/- (instead Rs. 2,48,999/-) respectively. The correct Gross profit rate was thus 8.88% only, but by reducing totals of both, sales and purchases by Rs. 1,00,000/-, the GP rate was shown as 12.09%.
- An assessee running a leather store disclosed a high rate of profit compared to other similar dealers, and double the income as compared to last year. Somehow, doubt arose and the accounts were minutely examined. It was found that purchases were mostly unvouched and were effected at very economical rates at a special place. Sales were in cash without mentioning the addresses of purchasers, even for large sales. This led to further enquiries which disclosed extensive business done by the assessee outside the books in the name of the employees and relations.
- In some cases, all the customers' accounts are duly recorded in the Ledger and the closing balances are made to tally with those in the customers' books, but the volume of transactions is surreptitiously reduced. It is, therefore, advisable to obtain in selected cases certified true copy of the assessee's account from the customers' books and to verify the accuracy of the transactions inter-se.
- Wrong totals are sometimes given for the debit side of the Trading account. Some invoices may be entered twice. Debiting speculation losses as loss in ready-trading is another practice. Giving wrong totals to weight etc. and making them tally somehow by the close of the year is also practiced. The inventories may be cooked up by making all manner of adjustments to or omissions from the original sheets. The original sheets of valuation of inventories should, therefore, be called for. In such cases insistence on the production of the books of original entry and other original data and record of purchase, sales, stocks, weights, stores etc. is necessary.
- In one case, the credit sales were not debited to customers' accounts and therefore these accounts did not appear on the assets side of the Balance Sheet as sundry debtors. To balance this omission, the total of the debit side of the Trading account was inflated by putting wrong excess total, so that though sales were included in the Trading account, the same amount was omitted by inflating the total of the debit

side of the Trading account. On enquiry, it was said that the Accountant who left the service did not post the credit sales to the customers' accounts and in order to make the accounts tally he put the wrong excess total of the Trading account. On reference to the customers, it was found that they had already paid the amounts, which the assessee had appropriated.

- Instances have come to notice where the assessees systematically inflate the purchase price by debiting the purchase account with an enhanced price and raising a corresponding credit in the account of the seller. This continues over a period of time and when the assessee is in need of funds, he makes out a cheque ostensibly in favour of the seller whose account is debited by the corresponding sum, while actually the cheque is either a self-cheque or in favour of a benamidar. In the latter case, the cheque is collected through the benamidar's account or through the assessee's own concealed bank account. A careful scrutiny of the seller's ledger account coupled with the time lag between introduction of fresh funds into the business and payments through cheque, can bring out the real nature of the transactions. Alternatively, if the seller's account in the assessee's books is cross-checked with the assessee's account in the books of the seller, the irregularity may come to notice.

- It is common for large concerns to obtain loans or advances from banks against stocks available with them. In the case of an assessee who maintains day to day stock tally, the stock position existing in his books can be compared with the position existing in the bank records and the assessee can be asked to explain the difference in the two figures. The position at the close of the year should be specifically seen to find out that closing stocks have been correctly recorded by the assessee. Where the assessee does not maintain day to day stock registers or stock tally, but records quantities in the Trading accounts, the quantity of stocks in hand on a few dates chosen at random may be worked out with reference to opening stock, purchases and sales, and the same may be compared with the quantities in the bank records. In the case of the assessees who do not maintain any quantitative details, stock values computed as per books may be compared with the stock as per the bank and the assessees should be asked to explain any wide disparity.

- An assessee had stocked his goods with the State Warehousing Corporation and took Warehouse receipts, containing details of quantities of stocks kept in the warehouse. Warehouse receipts are signed by the warehouse superintendent and are negotiable instruments. These warehouse receipts were handed over by the assessee to two banks as security for loans given by these banks. Substantial suppression of stock was discovered when a comparison was made of the figures in the assessee's accounts with the figures as per bank records. The suppression was clearly proved with the help of the discharged warehouse receipts obtained from the warehousing corporation.

- It sometimes happen that if an assessee has substantial unabsorbed depreciation/ loss, he uses this opportunity to convert his unaccounted money by showing bogus profits. For this purpose, the assessee shows high profits from the same or a new activity. Since the assessee itself shows good profit, there may not be any investigation by the department, yet it may be a pointer for investigation because in effect, the assessee is not paying any tax despite showing good profit.

9. VERIFICATION OF G.P. RATES

9.1 The first step in the examination of a trading account is the determination of the rate of gross profit with reference to sales and comparing it with similar percentages in the past years, as

also in the cases of other assessees carrying on similar businesses. While making comparisons, like should be compared with like. It may, however, be pointed out that two persons in the same trade may show varying results even though both may be presenting their accounts correctly. A person who is trading on borrowed capital would like to have quick turnover and he might be satisfied with a low percentage of profit, while another person who is having his own capital may wait for his chance for higher profits. It is, therefore, necessary that the rate of Gross Profit shown by the assessee is compared with rates shown by other assessees carrying on business in circumstances which are reasonably similar. For calculating gross profit rate, it is essential that only those items of prime cost should be included which vary directly with the turnover, and which have a direct bearing on the trading operations only. If the accounts of assessees deviate from this principle, necessary adjustments should be made to the Trading a/c, for ascertaining correct GP rate.

9.2 The under-mentioned items, if included in trading or goods account should be excluded:

- Any item in the nature of a capital receipt or expenditure.
- Speculative profits or losses.
- Any receipt of expenditure of a casual and non-recurring nature.
- All items which are inadmissible for the purpose of computation of profits for income-tax purposes, such as charities, Puja expenses, personal expenses, income-tax and super-tax etc.
- Bad debts, interest on book debts, commission or discount received or allowed for prompt payment.

9.3 Similarly the under-mentioned expenses, ought to be included in purchases:

- Freight, cartage, loading/ unloading
- Customs duty
- Landing and clearing C\charges
- Toll charges, octroi.

9.4 Following further adjustments will be necessary wherever they occur in the accounts:

- Any sales to the assessee's own branches at cost price included in the sales should be excluded. An equivalent amount should also be excluded from the purchases.
- Any totaling mistakes etc. in the goods account should be adjusted before working out the gross profit rate.
- If a joint manufacturing and trading account is kept, an attempt should be made to bifurcate it and determine separately the manufacturing and trading profits. Only the latter should be taken into consideration for comparison purposes.
- Sometimes assessees doing business on their own account also have transactions on commission basis. In such cases, the transactions on commission basis should be excluded.
- If stocks are valued at market price, calculation should be made on total sales plus the closing stock. If, however, stocks are valued at cost price, then the closing stock should not be included in sales, but the value of the closing stock should be deducted from purchases. The opening stock should be taken into account in purchases under both the methods.

9.5 Where an AO finds that gross profit rate shown by the assessee is significantly lower than the rates shown in the past or the rates shown by other similar traders, an attempt should be made to find out the reasons. Looking to the type of trade and business conditions, he should investigate the causes for any abnormal results. Investigation may also be called for, in cases where books have been disclosing more or less constant turnover and almost identical Gross profit rates, year after year. The AO has to see

whether the accounts produced were maintained in the normal course of business.

9.6 Another method of locating manipulation of trading a/c for adjusting rate of gross profit is by working out month wise trading accounts. In this, the assessee is asked to furnish monthly details of purchase, sale and rate of gross profit. The sales are readjusted by deducting there from the G.P. shown and thus determining the cost of sales. Thereafter, opening stock should be taken. Monthly purchase should be added to it and cost of sales should be deducted . Thus, monthly closing stock balances can be obtained. These stock balances may give useful clues about manipulation in books, as there may be negative stock in some months. A note of caution here is that this is an approximate method of working out the monthly closing stock, as the average GP rate for the entire year used in the above calculations may itself vary considerably during the year under consideration.

9.7 Periodical Analysis of Purchase/ Sales: Where the gross profit rate is low as compared to normal expectations, it is not always possible for the AO to verify purchases/ sales, and find out bogus or inflated purchases or under-stated or omitted sales. However, a rough and ready method can be devised. The assessee can be asked to sort out purchases in quantities and value and the average purchase rate for specified periods, say some fortnights. Likewise, particulars of sales in quantities and value as also the average selling rate for the same periods or fortnights, can be obtained. The AO will thus have data to form a quick judgment of the accounts in so far as they relate to purchase and sales transactions. If for a particular fortnight, the average purchase rate is much higher than the average selling rate, the reasons can then be examined in detail. There may be either inflation in purchases or understatement in sales. The AO can concentrate his inquiry on a detailed scrutiny of the transactions limited to such fortnights. For example, if it is found that the purchases for this fortnight are largely in cash, the question whether they are either bogus or inflated should be examined. Similarly, if it is found that in a particular fortnight the average selling rate has declined as compared to the earlier fortnight or fortnights, and if one finds that sales in such fortnights are unduly large as compared to the sales in the earlier fortnights, there is reason to suspect that the sales in this fortnight have been understated in the books. If it is possible to pinpoint manipulation by examining the transactions of a few fortnights, then a detailed examination and analysis should be made by the AO.

10. COMMON DEFECTS IN BOOKS

10.1 It must be borne in mind that, mere fall in GP rate cannot be sufficient ground for rejecting the books of account *u*/s 145, and for substituting the AO's estimate of GP in place of the disclosed gross profit. This is possible only when books of account suffer from defects of such a nature of omission or commission, that it is not possible to ascertain the true and correct picture from the same. Some common defects noticed in the books of accounts are:

- Some purchase are not recorded in books of accounts, or are inflated,
- Sales are suppressed or understated,
- Production is found to be suppressed,
- Books of accounts are found to be not written regularly on day-to-day basis, but appear to have been written recently in a few sittings.
- In the cases of manufacturing concerns, day-to-day production registers are not maintained.
- Production register shows over-writing of figures of production and insertions for quantity of shortages or process losses etc.
- There is an abnormal gap in the production, in the case of a running unit.
- In the cases of contractors, stock registers, labour registers, etc are not maintained.

- Some bank entries is missing either in bank book or journal or cash book.
- Gross under-valuation of stock is found.
- Difference between stock shown in books and stock statement submitted to banks.
- Some expenses incurred are not recorded in books, or are over-stated, etc.

11. ESTIMATING FAIR G.P. RATE

11.1 Where books of account and disclosed trading results are rejected for lawful and valid reasons, the AO has to estimate a reasonable and fair rate of gross profit. This can be done either on the basis of the past record of the assessee, or of some comparable cases.

11.2 Alternatively, some statistical tools can be used, ensuring that the results satisfy the twin criteria of fairness and reasonableness. Statistics has well-settled principles of random sampling from which over-all results can be predicted. For this purpose, a reasonable sample size can be selected out of purchase and sale transactions of the assessee, from which average rate of gross profit can be worked out and applied to the disclosed sales. Statistics also has methods for ascertaining the reliability of results of such samples. There are different formulae for different levels of accuracy. A confidence level of 90% would generally be a good indication of the reliability of the estimates. The sample should be selected on a deliberate random basis. For example, first five or ten sale transactions of every month can be selected and the assessee can be asked to give details of purchase of corresponding items. The total of such purchases and sales can be used for ascertaining gross profits, which can then be adjusted. A sample size of 5% i.e., every 20th sale transaction of the whole field is usually considered very reliable. The results produced by a given sample can be tested for their accuracy through other statistical techniques of finding out standard deviation and standard errors of the given sample. The Gross profit rates estimated by following these scientific/ statistical methods, would be more reliable, if based on a reasonable sample size and selection method. Thereafter, it will be for the assessee to disprove the same.

11.3 In cases of difficulty in estimating reasonable GP rate, complexity of the case and the quantum of work involved, provisions of Section 142(2A) can be used, and the work can be entrusted to an Auditor for special audit, with specific directions to work out estimates of fair gross profit rates, applying statistical principles, on sufficiently large random samples of sales/ purchases, and to establish the statistical accuracy of such samples. This method is very useful in cases where stocks cannot be physically counted because of practical difficulty of sizes, variety, etc of stock, e.g. auto-spare parts, mill machinery stores, large departmental stores, etc. It is however, not possible to apply this in cases where the items mentioned in sale bills cannot be correlated with those in the purchase bills for want of proper description of items in the bill. This method is also not appropriate for cases where the assessee is evading income by understating the value in sale bill while keeping the quantity intact. This generally happens in cases where rate of Central Excise or Sales Tax are very high and the assessee evades these by understating the value.

CHAPTER

7

Manufacturing Account

1. A Manufacturing account, though similar to Trading account in many respects, is materially different from it. Manufacturing account is prepared by concerns engaged in production, manufacturing or processing of goods. While examining the Manufacturing account, and its supporting records, it is necessary that an AO has a first-hand knowledge of the manufacturing process, the raw materials being used, the variety and quality of items being manufactured, their input & output ratios, and the by-products and wastages, etc. of the process.

2. Manufacturing Activity can comprise of one or more of the following:

- Production of goods or articles, which are entirely different from the raw material.
- Making of articles or goods which are essentially a changed form of the raw material.
- Processing of semi-manufactured goods into finished goods.
- Activities of changing shape of articles or goods.
- Assembling of finished or semi-finished parts and articles into new products.

It is important to know the exact production process starting from raw materials/ consumables, to the actual operations on these, and up to the production of finished goods, by-products and waste items. It is only with this knowledge that the records and expenses relating to manufacturing activities can be examined or evaluated by an AO.

3. A common format of manufacturing account is as under:

Manufacturing Account

To Opening Stock	By Goods Manufactured
Manufactured goods	(transferred to trading a/c)
Work-in-process	By wastages
Semi finished goods	By damage of goods
Raw material	By process shortages
Packing material	By work-in-process
	By closing stock

To Purchases (less returns)

To direct expenses

- Carriage inward
- Loading and unloading expenses

- Factory lighting and electricity
- Sundry manufacturing expenses

To Gross profit

The above format represents a general approach and may vary from assessee to assessee. In most of the cases, a common Manufacturing/ Trading account is prepared by the assessees.

Details relating to opening stock, purchases, sales and closing stock, have already been discussed in the preceding chapter relating to Trading account, and would be discussed here only to the extent there are additional features relating to manufacturing concerns.

4. GENERAL PARTICULARS OF MANUFACTURING ACTIVITY

4.1 It is advisable for an AO to know the following facts of the case, so as to enable him to form a proper opinion about the results of the manufacturing activities:

i. Installed capacity of the unit.

ii. Capacity shown to be Utilised by the assessee.

iii. Reasons for gap between above two.

iv. Unit cost of main raw materials.

v. Monthly production of different finished goods in terms of quantity and percentage.

vi. Monthly quantity consumption of main raw materials, and utilities like electricity, water, etc.

vii. Whether quantitative co-relation is possible in respect of consumption of main raw materials and production of main finished goods.

viii. Extent and areas of shortages, burning losses and wastage.

ix. Comparative data of yields and input & output ratios of past years.

x. Whether purchase of main raw material is from a local area or from outside state.

xi. The level of technology being utilised, age of the main plant/ machinery, and extent of automation.

xii. Nature of records and registers maintained, including those prescribed under other laws e.g. GST, Labour laws etc.

5. OPENING STOCK

Normally, closing stock of the preceding year becomes opening stock of current year. Quantitative tally of the opening stock can be made with figures of closing stock of the preceding year. It is possible that though the value of opening stock is not changed, but quantity of opening stock is generalized and intermixed in such a way, so as to take advantage of a larger quantity of raw material for production in the current year. In case there has been a revaluation of opening stock, the matter may need a deeper examination.

6. PURCHASES

6.1 A major part of expenditure in manufacturing process is on account of purchase of raw material. Therefore, due attention needs to be given to verification of purchases. The purchase account of raw materials may need investigation in cases of abnormal production or input: output ratios. This may involve verification of following records:

i. Purchase invoices, purchase bills, performa invoices.

ii. Delivery challans

iii. Bills of transportation/E-way bill as per GST Act

iv. Slips of measurement, weighments

v. Octroi bills or municipal corporation cess charging bills

vi. Loading & unloading vouchers

vii. Gate pass slips

viii. Inward register

ix. Purchase register

x. Stock register

xi. Store register

While going through the documents relating to purchases, one has to co-relate these with the corresponding entries of consumption of raw materials.

6.2 Details relating to major purchases of main raw material showing dates, quantity, price and direct expenses on these purchases, may be obtained before proceeding for detailed examination, as average purchase price of main raw material is a main factor in cost of production.

6.3 Average Input: Output Ratio of main raw materials and finished goods of a given industry generally remains constant. These ratios represent number of units (or weight) of raw material(s) consumed to produce one unit of finished good. There, may however, be variation in this on account of quality of raw material, age of plant/ machinery, level of technology/ automation, etc. Normally the input: output ratio of a given industry in a given year should be comparable with the historical data of earlier years, data of other comparable industries of the area, and over-all industry norms. The data on input: output ratios is maintained by the GST department, trade associations, CMIE (Centre for Monitoring Indian Economy), Industries department, DGTD (Directorate General of Trade and Disposals), etc.

6.4 It may be useful to isolate/ identify the purchases of doubtful nature, for detailed verification. The AO can obtain list of purchases exceeding a certain amount along with full addresses of suppliers, quantity, rates, particulars of direct expenses etc. These may be verified with the records of the suppliers. Any discrepancy in the copies of accounts obtained, *vis-á-vis* the accounts in the books of the assessee, calls for further scrutiny. Where a manufacturing concern is suspected of entering spurious purchases, the entries may be required to be traced right from the time the raw material was received at the place of arrival, its entry into the assessee's premises, its stacking in the godown, and its issue to the first stage of manufacturing. For this purpose, railway and carting records, gate inward register, bills of loading, and stacking records, etc., may have to be scrutinised.

- In the case of a textile mill, it was found that laga charges were customarily paid to certain trade associations for all cotton bales purchased by the Mills. Analysis of these charges provided a check on the quantity and number of cotton bales purchased by the textile mill. Business customs vary, but knowledge of such customs provides checks that can be applied for verification of accounts. Similarly, transportation of cotton bales from railway station to the premises of the manufacturing concern is often made through carts, which are paid on trip/ quantity basis, i.e. the expenditure is relatable to physical quantities.

- In the case of an oil mill, it was found that bogus purchases of groundnut and groundnut cake were shown from local farmers, and solvent extraction plants. In order to justify these purchases, fictitious intermediaries were introduced, who used to issue bogus sale bills, and receive sale price through cheques. The cheques were deposited in a bank account setup through a benamidar, and the proceeds of such cheques were withdrawn in cash by such benamidar of the assessee.

6.5 Purchase registers, normally, have various columns showing date of purchase, quantity, value, date of arrival, date of issue for production, etc. This information, together with transport

bills, gate passes, excise/ GST records, can provide very valuable clues for verification of genuineness of purchases, as also correctness of the quantity produced from such raw materials.

6.6 Usually consumable stores or raw materials are not purchased for sale. Therefore, whenever any amount is credited in the stores or raw materials account on account of sale, these should be properly verified. The possibilities in such cases are that-the stores might have been sold without full sale price being credited in the relevant accounts, or sale might be made at a nominal price to another connected person, who in turn might sell the goods at a higher profit, or the goods might be repurchased by the assessee at higher prices.

- In the case of a limited company, a large stock of cotton had been shown as sold to a charitable trust and another concern at a nominal cost. The company used to close its accounts on six-monthly basis. Accounts for the first half-year revealed that stock worth Rs. 10 lacs were shown as "damaged" and valued at Rs. 2 lacs only. Accounts pertaining to the second half-year disclosed that these very stocks were sold to two parties-a charitable trust and a private limited company of the same group, for a sum of Rs. 3 lacs. A nominal profit of Rs. 1 lakh was shown in the second half-year although on the whole there was a loss of Rs. 7 lacs. On being questioned, the company replied that the stocks had been damaged in transit due to excessive heat. The AO was not satisfied with the explanation. He found that, there were meetings of the Board of Directors every second month for examining the financial affairs of the Company. The examination of the minute book did not reveal any reference to the loss on account of damage of goods in transit. It was also found that the charitable trust which was running a weaving mill had used the cotton as such for weaving of yarn. The other company in turn had sold the same stock of cotton to another company which used it as such for production of yarn without subjecting it to any special process. The percentage of production of yarn from so-called damaged cotton was also normal. The evidence thus pieced together established that the assessee company had manipulated accounts to divert part of its profits to other concerns.

6.7 While verifying the purchase account, cash purchases should be compared with credit purchases of same date. If purchases are accounted for in manufacturing or sales account and closing stock but the rates of such purchases are not at par with the credit purchases made around the same time, there would be a possibility of inflation of purchase price.

6.8 Purchases from agriculturist, hawkers, petty scrap dealers, etc., can be inflated easily by preparing necessary self-vouchers. Over-invoicing of imports of raw material is also a common method to reduce profit by inflating the cost of purchases. In cases, where products are sold to government organisations, co-operative societies and reputed company, etc., and the sale proceeds cannot be suppressed, there is a greater possibility of inflation of purchases of raw material by raising bogus purchase bills either by getting these printed or through self-created vouchers.

7. MANUFACTURING EXPENSES

7.1 The next major head of expenditure is direct expenses incurred on various items in the course of manufacturing process. These expenses may be on account of the following:

1. Consumption of electricity and fuel
2. Carriage inward
3. Direct factory labour/ wages

4. Consumption of stores and spares
5. Maintenance and repair charges
6. Purchase of miscellaneous items
7. Sundry manufacturing expenses.

7.2 Since manufacturing expenses are directly relatable to the quantity of raw material consumed, and/ or quantity of finished goods produced, any manipulation of these expenses can mean either that the expenditure is inflated, or conversely that the production is suppressed. Month wise details of the main manufacturing expenses, e.g., electricity, fuel, labour, etc., and their comparison with production particulars of the corresponding month provides valuable data regarding veracity of the records maintained by the assessee.

- In case of an oil mill, it was found that in the month of May, electricity consumption was of 1300 units, but production was "NIL", whereas in the month of June, on a consumption of 1300 units of electricity, production of 70,600 kg of groundnut oil was shown.

7.3 Miscellaneous Expenses, repair expenses etc., can also be easily inflated by preparing self-serving documents or vouchers, which have to be scrutinized properly.

7.4 Stores represent a variety of different items consumed in the process of manufacture, and sometimes their consumption is very substantial. The AO has to be cautious that the stores claimed as consumed are reasonable in quantity and value. The purchase of stores should be verified with other purchases. The closing stock of stores is generally valued at cost and this valuation also needs to be checked. In so far as quantities are concerned, sometimes the incomings and consumption are shown on day-to-day basis, and then the balance is shown as closing stock, writing off the shortages, if any. Such shortages should normally be negligible. Some assessee total up the opening stock and the incomings, and the closing stock is then deducted, thus arriving at the consumption. Large concerns generally follow the former method. The manipulation in stores accounts are generally in the nature of showing stores as consumed without actually doing so; these items might have been sold and the money pocketed. The daily consumption of stores may therefore, be test-checked, and if on a particular day, any particular item of stores shows a heavy consumption, it should be looked into. A check regarding the physical receipt of stores is available by way of entries in the Gate pass book.

7.5 The other major items of manufacturing expenses like wages, fuel etc., should be co-related with the production at important intermediate stages. If the ratio of such expenses is unusually high, explanation for this should be obtained. If the explanation is not reasonable or not supported by evidence, a suitable proportion of such expenses can be disallowed. If the ratio of manufacturing expenses shows an abnormal increase, there can be a possibility that the production is being suppressed from the account books, though the full expenses incurred are being debited in these books. Careful enquiries should be made to locate this suppressed production. A reference can be usefully made to the records of transporters/ Railway, to test-check the sales and dispatch of the finished goods. Production records can be analysed on periodical basis, say monthly or fortnightly, to isolate periods when the input: output ratios are abnormally skewed.

7.6 In large manufacturing concerns, repair expenses also can be very high. Here it needs to be verified whether any substantial parts of the plant/ machinery have been replaced, and such expenditure has been claimed as revenue expenditure, whereas such substantial replacement may be capital in nature.

7.7 Expenses on labour charges can be verified with the statutory records, required to be maintained under labour laws. Details in this regard may be seen in the Chapter on "Engineering Industry".

8. PRODUCTION RECORDS

8.1 Any suppression of profit through understatement of production, inflation of purchases/ consumption, under valuation of closing stock, suppression of production of by-products, etc., is possible only through manipulation of production records. Therefore, an AO must verify production records with great care. The first issue requiring verification is whether there is any difference between installed capacity, the capacity utilised, and the actual production during the year. Any substantial difference or a decline in production compared to earlier year may be a starting point for a detailed inquiry.

8.2 It is important to ascertain whether the production unit is of continuous production type, or batch production type, and what is the average time lapse for completion of one production cycle.

8.3 Most of the manufacturing concerns come under the purview of Central Excise/ GST Act, which require maintenance of certain statutory records relating to production and removal of excisable finished goods. Details of these requirements are given in the Chapter relating to Engineering Industry. Certain manufacturing concerns also come under the purview of Cost Audit Rules, under the Companies Act. Details in this regard may be referred to in the Chapter relating to Cost Audit.

8.4 While verifying the production account, an AO may examine entries in the inward registers, and stock registers relating to issue of raw material, and the corresponding entries relating to production of the finished goods. The over-all input: output ratio of main raw materials and main finished goods can be worked out and compared with similar historical data of the same concern, as also with other comparable cases, and general industry norms. In case of abnormal variations, reasons for the same may be ascertained and verified. Where the reasons are not satisfactory, detailed verification of periodical production data, i.e. monthly, weekly, etc may be called and examined. Similar checks can be made to verify the declared shortages/ losses, and also the output of by-products.

8.5 In most manufacturing concerns, by-products of the production process are also an important source of revenue e.g. molasses/ bagasse in sugar mill; cotton waste, yarn waste, willow dust in cotton industry; saw dust in saw mills; sweepings in jewellery manufacturing concerns. The normal industry input: output ratios can be applied to test check the production of by-products also.

8.6 A correlation of sales (quantity and value) with month wise production may be necessary in circumstances of sudden or violent fluctuation in prices, as it is possible to understate sales by showing them in periods of lower market prices. The problem may require careful scrutiny in industries where forward contracts are in vogue for purchases of raw materials and sales of finished goods. The contracts in such cases must be examined against other contemporaneous evidence available, and preferably cross-checked with brokers' records.

- In case of a ground nut oil mill, normal yield was 31% to 33%, but the assessee had shown an average annual yield of 29%. When day-to-day production data was analysed, it was found that on 6-11-15, yield was 33.33%, on 7-11-15, it had come to 30%, and on 11-11-15, it had declined to 26.80%. The purchases were made in bulk in preceding months, and there was no evidence to show any change in the quality of raw material within 3–4 days, which could justify low yield. Therefore, the assessee was unable to explain the reason of low yield.
- In another case costing for the manufacture of 3 HP/ 1440 rpm electric motors was done. This worked out to Rs. 30,525 per motor. The sale price was Rs. 50,200/- to

Rs. 50,700/-. However, the GP disclosed in the books of account was much lower than that worked out from the above-mentioned figures of manufactured cost and sale price.

9. CLOSING STOCK

9.1 General discussions regarding valuation of closing stock made in the Chapter on "Trading account", apply to Manufacturing account also. Reference in this regard may also be made to the Chapter on "Balance-Sheet".

9.2 In CIT *u/s* British Paints India Ltd. (1991) 188 ITR 44 (SC), the assessee followed cost basis for valuing stock. However, while valuing the stock of raw materials, it included only the actual cost of raw materials and did not take into account the direct overhead charges. The Supreme Court held that direct expenses incurred for bringing raw material to the premises of the assessee, formed part of cost of raw material, and ought to have been included in the value of closing stock of raw material. The Court observed that, it was not only the right of the AO to take the correct value of stock but it was also his duty to do so for ascertaining the correct income of the assessee.

9.3 The issues relating to under-valuation of closing stock by a trading concern are also relevant for a manufacturing concern. In addition, manufacturing concerns are also required to value their closing work-in-progress (WIP) as on the last day. The AO needs to verify whether valuation of closing WIP has been done properly. Valuation of closing WIP is usually done at cost, by taking the estimated quantity of raw materials in various stages of production process as on the closing date, applying the unit cost of raw materials, and includes the estimated direct expenses depending upon the stage of manufacturing process at which the WIP was lying on the last date. By its very nature, this provides an ample scope of understatement, and therefore, needs proper verification.

10. ANALYSIS OF INPUT-OUTPUT RATIOS AND STOCK ACCOUNT

10.1 Where production records are manipulated, situations may arise that in the books there is no stock of raw materials to support the manufacture of goods, because either the quantity of goods available is suppressed in the opening stock; or some quantity of stock is held outside the books; or part of the goods accounted for in the books are not available for manufacture as these are kept by the banks under the key-loan account.

10.2 Even in cases where disclosed yield is satisfactory, analysis of input-output ratio for a part of the year may prove beneficial. The month-wise break-up of receipt of the raw materials and the production details can be obtained. The extract of month-wise purchases from the purchase account may not truly reflect the quantity of goods available in each month, as actual date(s) of arrival of goods may not tally with the date(s) of entry in the purchase account. In case production details are not available, the quantity of goods sold month-wise can be taken. There could be some confusion in a case where production registers are not maintained and where the assessee is engaged both in trading and in manufacturing, similar types of goods. In such cases, there would be difficulty in carrying out the input: output analysis. It may also happen that different standards of units are used to measure the raw materials and the finished goods. For example, yarn is accounted in kilograms, while the cloth manufactured from yarn is measured in meters. In such cases, the AO has to examine in detail the manufacturing process and arrive at a fair conversion factor from raw materials to finished goods. A thorough grasp of the manufacturing process is necessary for an effective analysis of input-output ratio.

10.3 After listing out month-wise receipt of goods and month-wise production, the period up to which maximum production has taken

place, should be found out. The input & output analysis can be done for the period from the beginning of the accounting year to the month (or the date) of maximum production. Having ascertained the quantity of goods produced, the next step would be to examine the quantity of raw materials necessary to produce such goods. Manufacturing processes are time-consuming and hence, it may take several days or weeks to reach the finished product stage. Therefore, at any point of time, some quantity of the raw material would always be stock in process. Therefore, while arriving at the quantity of raw material needed for production up to a certain date, the raw materials-in-process should also be taken into account. It can then be seen whether the quantity of raw material consumed, is correctly reflected in the books of accounts or not. While ascertaining the quantity of goods available as per the books, the opening stock of goods, relating to raw materials, finished, and semi-finished goods, should all be taken into consideration. If the assessee is having a key-loan account, then the goods lying with the bank should also be taken into account to arrive at the availability of raw material for production. Where the assessee is maintaining key-loan account with the bank, it is advisable to analyse records from the beginning of the accounting year to the date on which maximum goods are pledged with the bank, because pledged goods, would not be available for production, and unaccounted stock available with the assessee might have been used for production. If the quantity of production is taken from sales bills in the absence of details of production, then this figure will have to be reduced by the opening stock of finished goods, as part of the sales would have come out of the opening stock. The assessee would not have sold all the goods produced and some stock of finished goods would be available on the last day of the check period. Thus, the AO can estimate this closing stock at the end of the check period.

10.4 The minimum holding of raw materials would vary from case to case. Where raw materials are scarce, or are to be imported, or procured from distant places, assessees usually keep a substantial amount of buffer stock. There could also be cases where raw materials are to be cured or processed before they become fit for consumption. Such assessees also keep sufficient quantity of raw materials in hand. The AO can draw a stock statement of the following type:

Opening stock of raw materials	Quantity of goods produced
Add – receipts of raw materials up to the check period	Closing stock of raw materials
Opening stock of stock-in-process	(estimate of minimum stock holding)
	Closing stock of stock-in-process
	Wastage and by products
	Stock pledged in key-loan account.

Normally, both sides of the above statement should tally. If sufficient goods are not available as per books for producing the required quantity, then it would indicate investment in procuring raw materials outside the books. Where the AO proves the existence of raw materials outside the books, it would be better to recast the manufacturing account.

10.5 Examination of Stock Account where Driage is Claimed

10.5.1 Many agricultural products get dehydrated over a period of time. This loss of water is known as "driage". Driage occurs when produce such as copra, pepper, ginger, turmeric, etc., are stored. In these businesses, generally the assessee maintains day to day stock book. The driage is accounted for on weekly basis, monthly basis or yearly basis. In a case where driage is accounted on monthly basis entries in the stock register for driage would be as follows:

Opening stock	530	Sales	160
Receipts	40	Driage for the month	20
Total	570	Closing stock	390

Usually driage is not verified physically,as it is inconvenient to actually weigh the goods from time to time. But, where the assessee writes off driage in the stock account on weekly basis or some other periodical basis, it would be difficult for the AO to disprove the claim where the percentage or driage claimed is, as per the trade standards. However, where driage is claimed on yearly basis, it may be possible for the AO to restrict the claim of driage.

10.5.2 When driage is claimed on yearly basis, the entry in the stock register as on 31st March would be as follows:

Opening stock	40	Sales	960
Receipts	1020	Closing Stock (actual weighment)	70
		Driage	30
Total	1060	Total	1060

The driage, in the above mentioned case, works out to around 3%.

10.5.3 Assessees often purchase goods from farmers, and adjust a certain percentage from the weighment on account of moisture content. Payment is made to the farmers only on the net weight. Thus, part of the driage is already recovered from farmers. Where goods are purchased directly from farmers, the driage would be more as the goods are recently harvested/ processed. However, where the purchases are made from dealers, the driage percentage would be somewhat low as the dealers might have held the stock for some time. The AO can examine the percentage of driage claimed vis-à-vis the trade standard.

10.5.4 The AO can locate the lowest stock-holding close to the end of the year. Where the assessee quantifies the driage on yearly basis at the end of the year, the stock account would be as under-

Stock Tally Given by the Assessee

Op. Stock	335	Sales	10150
Purchases	10360	Closing stock	220
		Driage	325
Total	10695	Total	10695

If the lowest stock balance occurs on, say the 15th February 2018 as under:

Opening Stock	**Receipts**	**Total**	**Issues**	**Closing Stock**
240	15	255	75	180

The closing balance of 180 quintals on 15th February will represent the actual stock in hand after the driage that has taken place from the beginning of the year till 15th February 2018. It may be noted that here the driage is written off in the stock register only once in a year i.e. on the last day of the accounting year, and therefore on 15th February, no driage would have been written off. This would also mean that the trader has purchased 1670 quintals from 15th February 2018 to 31st March 2018, while the sales during this period are 1305 quintals. The stock statement would be as under-

Stock Tally of 15-2-18 to 31-3-18
(Figures in Quintals)

Op. Stock	180	Sales	1305
Purchases	1670	Closing stock	220
		Driage	325
			1850

The opening stock of 180 quintals has two components - the actual stock in hand and the driage up to 15.02.2018. The driage up to 15. 02.2018 cannot exceed the opening balance of 180 quintal. If we assume that the physical stock of goods as on 16.02.2018 to be NIL, it would mean the driage for the period 16.02.2018 to 31.03.2018 would be 325 (-) 180 = 145 quintals,

on purchase of 1670 quintals. Then the percentage of driage would be 8.5% against a normal of 3 - 4%. This anomaly will be extremely difficult to explain by the assessee. Therefore, even if the over-all driage claimed is reasonable, analysis for a particular period may bring out serious anomalies. This type of examination would be successful only if the stock is low on a date proximate to the close of the accounting year, and the assessee records the driage only at the end of the year.

CHAPTER

8

Consignment Account

1. GENERAL BACKGROUND

1.1 Any business entity has complete freedom to manage its own business affairs and this also includes organising its sales activity. The business entity always strives to distribute its products efficiently and effectively to all its customers who may be spread over a large geographical area or territory. In case of direct selling, the business entity has to setup branches or depots where stocks are transferred and sales are made from them. Such branches, depots, showrooms and offices involve incurring of huge expenses with attendant problems of maintaining the same on a permanent basis. This is usually avoided by indirect selling through agents. The business entity can appoint agents to whom stocks are transferred and these agents distribute the products to the ultimate customers and receive commission for the services rendered. One such way of indirect selling is selling through consignment agents.

1.2 To 'consign' means to send. The term 'Consignment' means the transfer of goods by one party (the Consignor) to the agent (the Consignee) and the goods are sold by the latter on behalf of and at the risk of the former. There is no contract of sale in case of consignment. The Consignor is the party who sends the goods to agents for sale, e.g., a manufacturer or a whole seller. The Consignee is the party to whom the goods are sent for sale. The consignment is outward consignment for the person who sends the goods and an inward consignment for the person who receives the goods for sale. The relationship between consignor and consignee is that of Principal-Agent. The ownership of the goods is retained by the consignor while the possession of the goods is transferred to the consignee. The ownership of the goods does not transfer to the consignee because of the agency relationship. An important feature of consignment sales is that the determination of sales price of the goods transferred is with the transferor. Similarly, the right of termination of the agreement is also with the consignor. The consignment sales can be made across State boundaries or even within the same State.

1.3 The consignee is entitled to a commission for selling the goods. Usually, the consignee

recovers all expenses incurred by him on the goods sent on consignment by the consignor. This feature is subject to agreement between the two parties. It is also normal for a consignee to give an advance payment to the consignor in the form of security, cash or a bill of exchange etc. which is adjusted against the final sale proceeds of the goods. If any goods remain unsold then they are generally returned to the consignor. The consignee is treated as a debtor only to the extent of the sale proceeds retained by him when the goods or a part of them have been sold by him. Consignment is a fairly common commercial transaction in international trade also especially in respect of those goods which cannot be standardized in respect of quality such as tea, coffee, wool or even heavy machinery and equipment etc.

1.4 For his efforts, the consignee receives a commission which is calculated on the basis of gross sale and it is usually a fixed rate on the proceeds of the goods sold. In addition to this commission, the consignee is to be reimbursed for all expenses incurred by him in connection with the consignment sales as agreed upon. The reimbursement of expenses is dependent on the exact terms of the consignment agreement. In normal cases the consignor advises the consignee to sell the goods consigned to him for cash only because if such goods are sold on credit by the consignee and if any amount becomes irrecoverable from the debtors, the loss will fall upon the consignor as the consignee can claim to have acted only as an agent in effecting the sales. The consignee does not become responsible for any bad debts. However, sometimes an arrangement is made between the consignor and the consignee whereby the latter guarantees payment and undertakes responsibility for bad debts also. For this the consignee receives an additional commission known as del credere commission on the total sales. When del-credere commission is given to the consignee, the consignee will make payment to the consignor, whether he himself receives the payment or not from the purchaser(s).

1.5 Another type of commission is the Overriding commission, which is allowed to the consignee as an additional incentive for the purpose of developing market for new products.

2. ACCOUNTING OF CONSIGNMENT SALE

2.1 The Consignor seeks to record the consignment sales in such a way that the profit or loss of each consignment can be ascertained separately. It requires the preparation of a special account known as *consignment account,* which is a nominal account prepared to find out the profit or loss of a consignment. The account is debited with the cost of goods sent, expenses incurred by the consignor/ consignee and the commission due to the consignee. The account is credited with the amount of sales affected, the advance payments received and also with closing stock, if any. The balance of this account is either profit or loss. Since the despatch of the consignment does not result in sale for the consignor but is only a transfer of physical possession over the goods, the personal account of the consignee is not debited and the sales account also does not get credited. These entries are made only after receiving Account Sales from the consignee.

2.2 In addition to the consignment account, the consignor also prepares the personal account of the consignee to ascertain the amount due to/ from the consignee. This account is debited with the amount of sales affected by the consignee and credited with the amount of any advance received from him, expenses incurred by the consignee and the commission payable on sales. The balance in this account is the amount due from the consignee. The consignment account in the books of consignor will ultimately show the net profit or losson account of consignment business. At this stage, the necessary entries are passed in the Trading and Profit & Loss Account and the consignment account is closed. It is also noted that a separate consignment account

is opened for different agents. This enables the consignor to know profit or loss on each consignment.

2.3 The accounting of Unsold Consignment Stock is also crucial in determining the profit/ loss of the business. The relevant details are obtained by the consignor from the consignee at the close of the financial year. The unsold stock is valued to ascertain the profit on the consignment as at the Balance Sheet date. The consignment stock balance is a Current Asset (it appears in the asset side of the Balance Sheet). At the commencement of the next financial period, consignment stock will again get transferred to the consignment account as a debit to enable the determination of the profit or loss on the sale of the remainder of the consignment.

2.4 An 'Account Sale' is prepared by the consignee setting out the sales made by the consignee, the expenses incurred on behalf of the consignor, the commission due to the consignee and the balance due to the consignor.

3. CONSIGNMENT SALE IN PRE-GST PERIOD

3.1 In the pre-GST era, the consignor would not send an invoice to the consignee. The consignor only sends a performa invoice, a statement that looks like an invoice but is really not one. The object of the performa invoice was only to convey information to the consignee regarding particulars of the goods sent, giving indication of the price of the goods at which the consignee ought to sell the goods etc. The performa invoice does not make the consignee responsible to pay the amount named therein. The consignor would send the goods to the consignee without any payment of VAT as there was no sale involved at this stage and no CST was required to be paid if the 'F Form' was issued. The 'F form' was a requirement for stock transfer to consignment agents or vice-versa from one state to another, without attracting charge of CST. The 'F Form' was used to prove that the goods are sent out to other states on 'stock transfer basis' and not on 'sale basis'. The consignment agent receiving such stock transfer consignment would issue 'F Form' to the consignor. The payment of sales tax would come into the picture only when the consignee sold the goods to the end customer.

3.2 After the consignee makes the sale and if a Form F was issued by him, the consignee would pass on the amount collected from the customer (including VAT/ CST) to the consignor after deducting his commission and minus the service tax charged on the commission. While filing their respective Sales Tax Returns, the consignor would then pay the VAT/ CST component to the respective State government and the consignee would pay the service tax component to the Central Government. If no Form F was issued, the consignee would pass the amount collected from the customer on to the consignor after reducing the VAT/ CST charged, his commission and the service tax charged on the commission. While filing Sales Tax Returns, the consignee would then pay both, the VAT component to the respective state government as well as the Service Tax component to the Central Government.

4. CONSIGNMENT SALE UNDER GST REGIME

4.1 The key difference now is that as per the CGST Rules, both the consignor and the consignee are considered as distinct persons as far as taxation is concerned. Thus, if there is a transfer of goods between the two, GST will be applicable even if there is no consideration paid. However, the agent/ consignee can avail input credit of the GST charged by the consignor. Similarly, while selling the goods to the end customer, the consignee should charge GST from the customer, which he directly pays to the Government. In addition, the Consignee has to charge GST at 18% on the commission receivable from the consignor and pass that on to the government as well. While paying GST to the government, both the consignor and the

consignee can adjust the same against their input tax credit.

4.2 In case the goods are not sold, and are returned, GST will be payable by the consignee even when returning the goods. The consignee can offset the GST which was earlier paid by the consignor while sending the goods. Further, the consignor can offset the GST paid by the consignee the next time he supplies those goods.

4.3 This above situation may lead to a misuse of a variant of consignment sales i.e. the sale on approval basis under GST. Unlike the consignment sales, sales on approval basis are not deemed as supplies under GST. Hence, the consignor may send the goods to the consignee by issuing a delivery challan instead of a tax invoice and without charging GST on the same. However, once the goods are sold by the consignee to the end customer, it implies that the agent has accepted the goods received on approval. Once this sale has been ratified by the consignee, the consignor has to issue the tax invoice and charge GST. The consignee can collect the purchase invoice and avail the input tax credit on the GST paid. The CBEC has itself issued a Circular on 18th October 2017 clarifying that the goods which are taken for supply on approval basis can be moved from the place of business of the registered supplier to another place within the same State or to a place outside the State on a delivery challan along with the e-way bill, wherever applicable, and the invoice may be issued at the time of delivery of goods. For this purpose, the person carrying the goods for such supply can carry the invoice book with him so that he can issue the invoice once the supply is fructified.

5. POINTS FOR VERIFICATION

5.1 The first stage of investigation in consignment sale is to examine whether the same is actually a consignment sale or a sale as such. The transaction has to be evaluated against the pre-conditions of a consignment sale. In the case of *Hafiz Din Mohd. Haji Abdullah vs. State of Maharashtra* (1962) 13 STC 292 (SC) the Supreme Court had held that the terms in the agreement that goods were to be sold at prices fixed by the supplier, that prices of the goods were liable to be altered at the instance of the supplier and that the person to whom the goods would be supplied would receive a fixed remuneration for exertion and would be liable to remit the price soon after the sale was effected clearly indicated that the relationship created was that of principal and agent. In this case the Supreme Court held that though as per the agreement the risk in the goods was on the agents, both during transit or when the goods were in the agents' place, the title in the goods was not affected thereby. It was held that such transactions did not amount to sale.

5.2 The intention of the parties to the consignment agreement is also crucial. For a consignment to be termed a sale, there must be two parties to the contract who are competent to contract, there should be mutual assent, there should be a transfer of property and valuable consideration must exist. If the agent is only facilitating a direct sale between the consignor and the customer, it is a sale. The Supreme Court in the case of *Bhopal Sugars Industries Ltd vs. STO* (1977) 40 STC 42 (SC) has held that the terms of the agreement, the intention of the parties and the dealings between them will determine the nature of transaction as to whether the transaction is asaleor transfer to an agent.

5.3 The assessing officer should also examine the accounting of the sale proceeds of the consigned goods and the valuation of the stock with the consignee at the end of the year. The assessee can suppress the income earned in the consignment business by manipulating its sales account or by suppression of value of stock with the consignees or both. The AO can also verify the reasonableness of the expenditure claimed by the consignor.

5.4 Since earlier the consignment sales were exempted from payment of CST/ VAT, many businesses would show consignment transfers to avoid payment of higher sales tax and this could also impact the time of accrual of sale consideration shown in the books. In such cases the agreement may exist only on paper. Therefore, scrutiny of the agreement assumes significance. The AO should examine the transaction and the work done by the consignee. The AO should also check the sale prices claimed and see whether these were at market rates or not.

5.5 The consignees are required to send the account statements containing the details of the goods sold and the rate at which the goods are sold. The usual practice is to account for sales only on receipt of the account statements. By manipulating the date of receipt of the account statements, a trader may seek to postpone the income by not crediting the sales account. The consignee may also act in collusion with the consignor and purposely delay the dispatch of the account statements. While examining the consignment sales account, the AO should invariably ascertain the period up to which the goods sent on consignment are reflected in the sales account. Normally, the assessee should have no difficulty in accounting the sales of goods sent on consignment up to the month of February. The sales relating to goods sent on consignment in the month of March may be reflected in the subsequent year as the account statements may have been received after the close of the accounting year. By not accounting the sales in the year of sale itself, an assessee can postpone payment of tax. The market trend of prices of the goods can also give a clue. If there was a boom in one financial year and a slump thereafter, the trader may find it advantageous to postpone recording higher realisation in the year of sale and record such sales only in the subsequent year. Thus, the assessee can manipulate the sales account and suppress the income in a year when the trade has done well. The plea of the assessee in such cases would be that the method of accounting regularly employed by him is to account the sales on receipt of the account statements from the consignee. This can be rebutted by making filed enquiries.

5.6 Where the likely tax effect is large, the AO may conduct a survey under Section 133A and ascertain the date on which the account statements were actually received. If it can be proved that the assessee had indeed received the account statements from the consignee before the close of the accounting year but he chose to postpone the recording of the income, penal provisions can also be invoked.

5.7 Suppression of closing stock with the consignees is commonly resorted to by the consignors. Some businesses omit to include the stocks sent on consignment or lying in transport depot or sent for approval of customers. The AO should call for the account statements and ascertain the goods actually held by the consignee at the end of the year. If there is omission in disclosing the stock with the consignee at the end of the year, an addition can be made to the closing stock. Similarly, the assessee might not have accounted for the goods in transit i.e. the goods dispatched by the consignor but not received by the consignee till the close of the previous year. Here, the AO can call for the account statements of the subsequent period and examine the date of arrival of the goods in the beginning of the subsequent year i.e. in the first fortnight of April. He can then find out when these goods were dispatched to the consignee and examine whether the goods in transit are reflected in the closing stock declared. There could be a time lag between accounting for the sales in view of the delay in receiving the account statements from the consignees. Often the sales made in the month of March are reflected in the sales account of the subsequent year. The issue to be examined is whether the assessee has included the goods covered by these statements of accounts in the closing stock of the previous year or not.

5.8 Some assessees may declare themselves as consignees in order to avoid disclosing the stocks purchased by them. A careful inspection of the documents required to be maintained can unravel the bogus consignment arrangement.

5.9 Examination of Balance Sheet and the ledger accounts of the consignor is also helpful. The consignee often sends money in advance and his accounts are credited on receipt of the money. When the goods are dispatched on consignment, normally the consignee's account is not debited. The debit entries are made only when the Account Sale statement is received from the consignee. The assessee can suppress the income simply by choosing not to reconcile the advances with the supplies made. Therefore, examination of the correctness of the credit balances, especially the balances carried forward from year to year, in the consignee's account is called for. A critical study of the consignee's account may help the AO to establish suppression of sales. The AO may also cross-verify from the consignee's end, wherever necessary.

CHAPTER

9

Profit and Loss Account

1. Profit and Loss Account, is the final account drawn by an enterprise to work out the profits and loss from its trading/ manufacturing activities. Conventionally, all the expenses and receipts directly related to goods traded or manufactured are taken to the Trading or Manufacturing account, while all other revenue expenses i.e. overhead charges, indirect expenses, interest etc. are debited to P/L account.

2. The format of P/L account may vary from business to business, and the accounting system/ method followed by a particular enterprise. This flexibility provides an opportunity to a clever assessee to include some expenses which ought to be included in Trading account, in the P/L account, and vice-versa, to present a desirable picture to the AO. If direct expenses, which ought to be debited to Trading or Manufacturing account, are debited to P/L account, this may present a higher G P rate than the actual, and may on cursory examination, lead an AO to accept the same. The key question, however, is that for ascertaining the reasonableness of disclosed GP rate, like must be compared with like. In other words, if some direct expenses which till the preceding year were being debited to Trading account, are shifted to P/L account in current year, the comparison will not remain fair.

3. The nature of expenses debited to P/L account will vary depending upon the nature of the business. The P/L account has to be examined with reference to Sections 30 to 44D of the Act. The common issues involved while examining the P/L account are:

i. Whether any capital expenditure has been debited to P/L account, as revenue expenditure.

ii. Whether any personal expenditure of proprietor, partners, directors, shareholders (of private limited companies), or of their relatives, has been debited to P/L account, in the garb of business expenditure.

iii. Whether any expenditure of prior or subsequent accounting period has been debited to P/L account.

iv. Whether any bogus expenditure, i.e. expenditure not supported by proof, or supported by false/ fabricated records has been debited to P/L account.

i. Whether any expenditure of the nature prohibited in the Act, e.g., expenditure on unlawful activities (Explanation to Section 37), payments to Non-residents without TDS u/s 195(1) (Section 40(a)(i)), has been claimed.

ii. Whether any expenditure which, as per the Act , is allowable only on Fulfilment of certain statutory conditions, or which is allowable up to a certain limit, has been claimed without Fulfilment of those conditions, or in excess of those limits. For example, depreciation at a prescribed rate is admissible only on fixed assets owned by the assessee, and used for business purposes during the year.

iii. Whether any expenditure has been incurred for earning exempt income like dividend, profits from partnership firm, agriculture income, etc. (Section 14A r w rule 8D) and claimed as deduction.

4. Some of the following expenses, which may be debited to P/L account may require detailed verification on the facts and circumstances of a given case:

i. Interest
ii. Depreciation
iii. Advertisement and publicity
iv. Repairs
v. Travelling - local and foreign
vi. Sales promotion/ commission
vii. Technical know-how
viii. Royalty
ix. Financial consultancy services
x. GST
xi. Insurance
xii. Rent, rates, etc.
xiii. Legal fees
xiv. Bad debts

4.1 Personal Expenses: Sometimes, personal expenses of proprietors/ partners, etc., which should have been rightly debited to their accounts are debited under some expense account appearing in the P/L account. Investigation to find out the extent of such expenses can be usefully carried out by scrutinising vouchers as well as the extent of personal expenses debited by the proprietors in their own accounts. Such examination is also necessary to find out what perquisites should be assessed in the hands of the directors, partners etc.

4.2 Illegal Expenses: Under Explanation to Section 37(1), any expenditure for any purpose, which is prohibited by any law, cannot be allowed as a deduction u/s 37(1).

4.3 Interest Expenses: The main points requiring verification before allowing interest expenses, are whether the borrowings were for business purposes [Section 36(1)(iii)] and for meeting revenue/ working expenses, as distinct from borrowings for acquiring a capital asset. The genuineness of payment and reasonableness of interest rates may also need verification on facts of a given case. It may also be necessary to verify whether any of the interest expenses are hit by the provisions of Section 43B of the Act.

4.4 Depreciation: Depreciation is admissible only on the assets owned by the assessee and used for the purpose of business during the year. Therefore, it may become necessary to verify the actual date from which an asset came in assessee's ownership, and the date from which it was put to business use. Certain assets are eligible for depreciation at a higher rate e.g. energy-saving devices, etc. Where such higher depreciation is claimed, it may become necessary to verify whether the conditions specified for the same are fulfilled or not. Details relating to manipulation for claiming higher depreciation, are discussed in the Chapter relating to "Balance-Sheet"- Fixed assets.

4.5 Advertisement and Publicity: These expenses may become significant in the year

when a new product is launched, or when a new issue of share capital is brought out. At times payments of the nature of donation may be given the colour of advertisement expenses.

4.6 Travelling Expenses: If these include expenditure on foreign tour for acquiring fixed assets, then such expenditure has to be capitalised or has to be considered as pre-operative expenditure. Therefore, the allowable depreciation u/s 32 or amortisation of expenditure u/s 35D has also to be taken into account. One has also to see whether any personal tour expenditure of the director/ partner/ proprietor is debited or not. Also, an examination of the travelling expenses may throw clues in relation unaccounted transaction of sales, purchases etc., as these may include expenses on travelling in connection with transactions or matters not disclosed to the Department. Such clues might also throw up names of persons or of commercial contacts, etc., which may, then be pursued.

4.7 Sales Promotion/ Commission Expenses: Often false/ inflated claims of payments of commission are made to reduce taxable profits. In appropriate cases, it may be necessary to examine claims of commission payments, in details especially in cases where no GST has been charged by the payee. If the entire commission is outstanding at the end of the year, then there are reasons to suspect and therefore, detailed examination of the genuineness of commission expenditure is required in such cases.

4.7.1 In one case, while examining the commission payments, the AO found that large amounts of commission were claimed to have been paid to some selected employees who were different in different years. The terms of payment were fixed under written agreements and the rates of commission varied with the quantum of net profits. income-tax was duly deducted from such payments by the employer and paid to the credit of the Government. The commission payments were disproportionate with salaries of those employees, in some cases even 5 to 10 times of annual salaries. Major portion of the commission was not withdrawn by the employees but was allowed to be retained by the employer, interest being credited against the undrawn balances. The outstanding amounts of commission were subsequently invested in shares of group companies and also given as loans to new companies floated and controlled by the employer, or were transferred as donations to charitable trusts created by the employer assessee.

4.7.2 In another case, in spite of a steady increase in turnover, there was a decline in the profits because large sums had been debited as commission and bonus. When examined, some of the employees denied the receipt of commission and stated that they were asked to sign blank vouchers and that the amounts alleged to have been paid to them were actually appropriated by the management.

4.7.3 While examining claims of abnormally large payments of commission or bonus, following line of inquiry is suggested:

i. Full information relating to the previous experience of the employee, his educational qualifications, relationship, if any, with the employer should be obtained.

ii. The nature of duties of the employee and total remuneration earned by a similarly placed employee in another comparable concern should be ascertained.

iii. It should be examined whether the payment of commission besides salary, was one of the conditions of service of the employee concerned at the time he was initially appointed. If not, the reasons for paying commission from a subsequent date should be carefully looked into. Even where there was an initial agreement, it would also be necessary to examine whether there has been any variation in the rates of commission, or in the manner of computing the amount payable, with a

view to finding out if the real motive for the change was to reduce the taxable profit.

iv. The final or eventual destination of the commission or bonus alleged to have been paid to an employee is of vital importance. It should, therefore, be seen whether the entire commission credited to the employee was withdrawn by him in the year of account itself or soon afterwards and, if not, how it was ultimately adjusted. If it is found that the commission is shown as having been fully or largely withdrawn by the employee, his account books and bank pass books, if any, should be scrutinised and, if necessary, he should be examined as to how the amounts were spent or invested by him and whether his standard of living, savings and investments were commensurate with his alleged income.

v. In case the withdrawals are shown as invested, investments should be followed up to ascertain whether they have ultimately gone back to the employer or his nominees.

4.7.4 In a variation of the same theme, the assessee may claim to have paid purchases/ sales commission to third parties. Here, two types of manipulation are possible. One type is that the transactions with the third parties are genuine, i.e. the fact of payment of commission is not in doubt; only the quantum of commission paid is inflated in the assessee's books of account. In such cases, a cross-verification of the books of account of the assessee with those of the third parties will bring to light the manipulations made by the assessee. The other type is where the assessee sets up a totally fictitious entity and makes a claim for deduction in respect of the commission allegedly paid to such an entity. In such cases, investigation must be directed towards proving that the ostensible is not real.

4.7.5 In one case, M/s. 'A', an assessee dealing in oil, claimed deduction for payments of gratuity, bonus and notice saelary to some of his employees. On inquiry, the AO found that the assessee obtained from these employees, written requests that they wanted to retire from service and so gratuity due to them should be paid. A scrutiny of these letters revealed identical language, and only the names, years of service and amount of gratuity were different. The books of account for the following years showed that these very persons, who were supposed to have retired, were in the employment of the firm. A close examination showed that, after their alleged retirement, these employee had, in identically worded letters, sought re-employment for the same vacancies, and had been re-employed by the assessee. Similar position was detected regarding thpayment of notice salary.

4.8 Technical Know How Fees: Under Section 35AB of the Act, where the assessee has paid in any assessment year commencing on or before 1-4-98, any lump sum consideration for acquiring any know-how for the use of the business, then only 1/ 6th of the amount so paid shall be deducted and balance amount shall be allowable in equal installments for each of the five immediately succeeding previous years. If such technical know-how expenditure is on know-how developed in laboratory, university or specified institutions, referred to in Section 32A (2B), 1/ 3rd of the lump sum consideration shall be allowed in the first year, and the balance amount shall be deducted in equal installments for each of the two immediately succeeding previous years.

4.9 Insurance Expenses: Even a seemingly innocuous account like Bima Khata (account for insurance premia), sometimes contain significant clues of tax evasion. In some cases, these entries have led to the discovery of transit insurance policies, Bag and Baggage policies, etc., which provided evidence about the unrecorded consignment of silver or gold, etc., and/ or ornaments, jewellery and other precious assets carried by air, rail, etc.

4.10 Legal Fees: An intelligent examination of the litigation expenses can throw up clues about the loans, investments, etc., which are missing from the books produced before the Department. These clues can then be pursued to their logical end by reference to the records of courts, banks, etc.

4.11 Bad Debts: Under the present provisions of Section 36(1)(vii), if any bad debt or part thereof is written off as irrecoverable in the accounts then it has to be allowed. Many of the assessees claim such deductions in P&L a/c, but show the same in the Balance Sheet as a provision for bad debt. This is wrong, because if in the Balance Sheet, the item is shown as provision, then the assessee cannot take plea that the debt has been actually written off as irrecoverable. In these cases, it is important to obtain full details of names and address of the debtor(s) from the assessee and thereafter, to find out whether the debtors have shown the items as income by way of remission of their liability.

4.12 Printing/ Stationery Expenses: These items may become important, if questions of authenticity of bill books, gate pass books, cash memo books, and similar records or; the time from which these became available to assessee or; the number of such books printed, etc., crop up as part of investigation into genuineness of records, expenses, etc.

4.13 Telephone Expenses: These become useful when particulars of outstation/ international calls are to be analysed for verifying any undeclared business connections. The scrutiny of these expenses is of importance in cases of speculation or commission agents in forward market.

4.14 Large Payments to Connected Persons: Large payments to connected persons may need examination, if such payments are used to reduce due tax liability. The AO should examine the applicability of the provisions of Section 40A(2)(b) and in deserving cases he may refer the case to *TPO for examination u*/s 92BA of the Act.

4.15.1 In a case, M/s. X, a printing press and M/s. Y a publishing firm, were two sister concerns. Printing charges paid by M/s Y, which were trade receipts in the hands of M/s X. M/s. X maintained regular books of account and was assessed on the results disclosed. M/s. Y did not produce books of accounts, and their profit was estimated by applying an estimated rate of GP on turnover. In order to reduce the overall tax liability, the printing press, *viz.* M/s X began to allow heavy rebates to the publishing firm, M/s Y on the printing charges payable by the latter. While this went to reduce the taxable income of the printing firm, it did not effect tax liability of the publishing firm Y, as it was showing its income and also getting its assessments made on estimate basis. It was hoped that the same rate which was being applied would be repeated in the pending assessments as well, irrespective of the quantum of rebate received. This method of reducing the tax liability came to light when the printing press X claimed payment of rebate of substantial amount to M/s Y.

4.15.2 A number of companies often claim payment of high salaries to close relatives of the persons controlling the companies. In some cases, the salaries are paid even though the relatives had not rendered any service, whatsoever. In other cases, the recipients were not found to possess any academic or technical qualification for the jobs assigned to them. In some other cases, they were found to be staying at places different from places where they were expected to render services.

4.16 Deferred Revenue Expenditure: This refers to expenditure in respect of which payment has been made or liability has been incurred, but benefits of which will accrue over subsequent accounting periods. Such expenses should normally be of a capital nature or allowable as a revenue expenditure in a subsequent year.

However, the Act provides for some of these expenses to be deducted as business expenses up to certain limit. For example, amortisation of preliminary expenses u/s 35 D. This has been discussed in the Chapter relating to "Balance-Sheet".

4.17 GST: With the implementation of GST, most of the payments are subjected to GST and therefore, assessee will mostly inflate those expenditure which are subjected to nil or minimum rate of GST. The AO should examine the genuineness of all such expenditure. The second possibility is that the assessee will show purchases from unregistered dealers. The AO should examine the genuineness of not only these expenditure but should also examine the genuineness of such unregistered dealers. The AO should have some basic idea of the GST information furnished by the assessee to the GST department, etc.

4.18 Advances Written Off: Many of the assessees debit this amount in the P/L account. The AO should examine the nature of advances i.e. whether they are on revenue account or capital account; whether the recipient of advances has shown the same as its income or not and accordingly may disallow this amount.

4.19 Expenditure on Scientific Research: Under Section 35 of the Act, deductions are allowed in respect of expenditure on scientific research. In some cases it is observed that the assessees have claimed bogus expenditure under this Section for the reason that either the association or university, etc. exist simply on paper and the payment made by cheque is received back in cash by the payer. The claim of such deductions needs thorough examination including third party verification.

CHAPTER

10

Balance Sheet

1. ANALYSIS OF BALANCE SHEET

Balance Sheet is a financial statement that lists the assets, liabilities and owners' equity of an entity at any given date, normally 31st March or 31st December of the year. When a business entity needs money it borrows either from the owners of the business or from outside. The money borrowed from the owners of the business is called *Capital,* whereas money borrowed from outside is known as *Loan*. Both owner's as well as lender's contributions are reflected on the liabilities' side of the Balance-Sheet. The other liabilities are *Current Liabilities* which include creditors, the amount payable to suppliers and vendors, and bank overdraft. There are modern instruments as well appearing as liability such as Perpetual Non-Convertible Debentures ("PNCDs") or Hybrid Bonds, which are often called as equity in disguise because of their nature and character. Assets, on the other hand, represent what the entity owns, or the things it has purchased by spending the money that it had borrowed. Typical assets include Investment in Land and Building, Plant and machinery, vehicles, Computer systems etc., which appear as *Fixed Assets.* The other category of assets includes items such as debtors, cash and bank balances and inventory, which are known as *Current Assets.*

1.2 The assessee and its agents have direct and indirect incentives to prepare Balance Sheet in a manner most suited to their needs and requirements. Several stakeholders (such as share holders, creditors, lenders including Banks, borrowers, pressure groups, Government in general and Tax Departments in particular, insurers, employees, agents in supply-chain management, acquirers and take-over holders etc.) are the users of the data in the balance-sheet. Government restrictions on funds and capital mobility, the lender's prescription for lending money, tax sops etc., could be the reasons for the assessee to show its Balance Sheet, in the manner it suits best. Since there is dichotomy between owners and employees, flowing from different provisions of the Companies Act, 1956, income-tax Act, 1961, the management may adopt such accounting policies as to give a

flattering opinion of its efficiency, effectiveness, etc. of the business enterprise. Such accounting policies are more appropriately described as "creative accounting" or "window dressing of Balance Sheet", either to "evade taxes" or to "defer taxes" or to "shift taxes" or "smurf taxes" etc.

1.3 It is very necessary for an Investigator to read between the lines and look beyond what is reflected in the financial statements. In other words, evaluation of the *off Balance Sheet items,* as also *hidden costs & values* is also, to be carried out to ascertain correct facts and logical conclusions.

1.4 It is also necessary for an Investigator to use various quantitative and qualitative tools, such as *cash flow statement.* The cash flow statement is one of the least manipulated financial statements. The other two financial statements *viz.* the Profit & Loss and Balance Sheet, are often subjected to many manipulations. However, while the cash flow statement does render more transparency, it too can be manipulated to a certain degree. With the analysts considering a sustainable cash-flow stream as the primary factor in determining the value of a company, the incentive to manipulate cash flows is greater. Hence, it is necessary to examine other tools such *as narratives to financial statements, ratio analysis, inter-firm comparisons, management performance evaluation techniques, management control systems,* etc to achieve the avowed objective. It is also necessary to verify compliance with applicable Accounting Standards, and ascertain the *Economic Substance* over *Legal Form*. For this reason, the AO has to keep in mind the motives, regulatory provisions, and such other reasons, which may prompt an enterprise to resort to *Creative accounting* and *Window Dressing* of Balance Sheet and other financial statements.

2. LIMITATIONS OF BALANCE SHEET

i. **Static Statement:** Balance Sheet per se is a static statement of Assets and Liabilities, giving statement of assets & liabilities only as on a given date. Therefore, Balance Sheet & Profit and Loss account have to be studied along with other financial statements.

ii. **Historical in Nature:** It imparts financial data recorded at historical costs. It involves blend of valuation methods known as Historical cost, Replacement Cost, Current Costs, etc.

iii. **Can Hide More than it has to Reveal:** There are numerous hidden values which are not reflected in the Balance Sheet, such as organisational culture, human assets, environmental costs, intangible assets, future earning capacity, etc.

iv. **No Consideration for Time Value of Money:** It does not take into consideration, the time value of money, inflation/ deflation, non-monetary items etc., Therefore due and necessary adjustments are required to be made to Balance Sheet.

v. **Share Holder's Statement:** Balance Sheet of Companies is mainly reported to suit needs of the shareholders. Requirements of other stakeholders, including taxman, may not be reflected "on" or "off" the Balance Sheet.

vi. **Window Dressing:** Appearance of Balance Sheet can be altered to present a rosy picture by using different accounting policies, or by pre-dating or post-dating transactions, the substance of which will emerge after the date of balance-sheet. As per SSAP-17 (Statement of Standard Accounting Practices–UK), Window Dressing is a situation, where:

- There is a fraudulent falsification of accounts to make things appear to be more favourable than they actually are
- The legal arrangement of affairs over the year-end to make things, look different from the way, they are.

vii. **Not Reflecting EVA/ CVA:** Balance Sheet may not reflect, whether the economic entity has created wealth for its stakeholders or not. In other words, it may not be useful for performance measurement and strategic valuation concepts of Economic Value Addition [EVA], Cash Value Addition [CVA], Value Drivers etc.

3. PRELIMINARIES OF ENQUIRY

3.1 In cases requiring detailed investigation, the AO should prepare a list of persons closely and proximately related or connected with the assessee along with the names of their close relatives. Information about their places of residence or places with which they have close contacts should also be obtained. Names of the business concerns with which such persons are connected should also be ascertained. Accounts appearing in names of such persons or businesses should be selected for thorough investigation. It may also be useful to prepare a list of employees/ nominee directors/ key persons who have been paid salary above certain limits depending upon the nature of the case and to examine accounts appearing in their names.

3.2 In the case of companies, firms or other assessees who require getting their accounts audited, Auditor's report should be carefully looked into. Section 216 of the Companies Act provides that profit and loss account shall be annexed to the Balance Sheet and the auditor's report including the auditor's separate, special or supplementary reports, if any. If there is any qualifying report, it should always be called for. The AO should carefully examine the qualifying observations of the Auditors, and should satisfy himself about their implications for assessment purposes. The printed accounts always contain copy of the annual accounts and the report of the Directors. This report should be carefully studied for useful bits of information. Thus, if the profits have gone down for a particular year, the Directors will naturally give reasons for it, and the AO should then scrutinize how far these reasons are reflected in the accounts. The report may make a mention about the future plans of the company and collaboration arrangements entered into, about which the AO will have to keep a watch.

3.3 Comparison with Last Year's Balances: The AO should note down against each account, the balances of the earlier year, particularly in non-company cases. The object of placing the figures as at the end of the last year along with the figures as at the end of the accounting year is to get a glance at one go the fluctuations in the balances. He should also be cautious about new accounts that have appeared and old accounts that have disappeared and mark out those accounts for appropriate scrutiny. He should also take note of those accounts in which balances have remained constant. Moreover, cash flow statement can be prepared for investigating movement in assets and liabilities.

4. BALANCE SHEET FOR THE FIRST YEAR

4.1 In case of new Companies, the AO should obtain following documents:

i. Memorandum, Articles of Association, Foreign collaboration agreement.

ii. The date of incorporation and certificate of commencement of business, whether it is "Part-IX" company or a normal new company.

iii. Particulars of Directors, Managing directors, Managing agents, secretaries and treasures, manager and Secretary/ nominee directors, and any incidence of PHOENIXISM (unscrupulous directors liquidating a limited liability business one day and starting an identical business the next day).

iv. The share capital and rights of various types of shareholders (voting powers etc.) Exchange ratio in cases of merger/ de-merger/ amalgamation etc..

v. The AO should obtain details as to how the share capital has been subscribed. The share holdings of the Directors including promoters' contributions, should also be ascertained.

vi. The agreement, if any, appointing Managing agents, or secretaries and treasurers.

vii. The AO should thoroughly verify the identity and capabilities of the shareholding companies and lenders so as to ascertain the genuineness of the contributions received from such sources and whether any contribution has come through *Name lending Paper Companies* or *Name lending firms or individuals.*

viii. The AO should ascertain whether the public are substantially interested or not; and whether it is a subsidiary company.

4.2 In case, there is a change in constitution of business for example, if a proprietary concern or a firm has been converted into a limited company or is de-merged company, etc., the AO should call for the agreement between the predecessor and successor and examine if there are discrepancies *vis-á-vis* the laid down law. It is not infrequently found that when a person takes over the business of another person or purchases the assets of another person without taking over his business, the successor or the purchaser, as the case may be, pays a lump sum for various kinds of assets taken over or purchased, some of which may not be eligible for depreciation. An assessee wanting to avoid proper tax may manipulate the allocation of the lump sum payment so as to get an excessive allowance for depreciation. In such case the lump sum payment should be allocated among the various assets according to their relative commercial value at the time of purchase.

4.3 A specific statement to the effect that nothing has been paid for goodwill is not conclusive evidence that the price of the assets has not been inflated to include a payment for goodwill. Where there is any reason to suspect that an unreasonably high price has been fixed on assets which are subject to depreciation allowance, the AO is entitled to question the price and to compare it with its written down value in the books of the predecessor and with the current market value.

4.4 Sometimes, a study of the assets and liabilities taken over, and those not taken over by the new concern may be revealing. Thus a business run by an individual may be converted into a firm but the firm may not take over liabilities in certain accounts. Such liabilities may be bogus credits belonging to the vendor. Transactions of taking over of liabilities by discounting the future stream of income, by loss-making entities need to be examined. For example, in the case of a proprietary business taken over by a limited company, analysis of the assets and liabilities taken over by the limited company revealed that certain liabilities of the individual were not taken over by the company. On investigation it was found that suppressed sale proceeds were introduced in the form of credits in the names of these parties.

5. ASSETS SIDE

The assets of a business entity would usually be classified as under:

* FIXED ASSETS

- Tangible Fixed Assets
- Intangible Fixed Assets
- Capital Work -in- Process (CWIP)
- Investments
  - Current Assets
  - Miscellaneous Expenses Not Written Off/ Deferred Revenue Expenditure

6. FIXED ASSETS

Fixed assets include land, building (both own & leasehold), plant and machineries, stores & spares, moulds, motor cars, electrical installation, furniture & fixtures, intangible assets such as know-how, patents, trade marks, copy right, licenses, franchises, other business or commercial rights of similar nature etc.

6.1 Initial Measurement of Fixed Assets

6.1.1 Tangible Fixed Assets: Normally, fixed assets are measured at cost. In the initial cost, other costs & expenses are also included by way of *Capitalization of Expenses* till the date of commencement of commercial business. These expenses include, land and other cost of the assets, interest on money borrowed for its purchase, bank charges, expenses necessary to bring the asset to site, install it and make it fit for use, etc. The business entity has therefore to choose whether to capitalize these pre-commencement expenses or to treat these as revenue expenditure. Moreover, pre-commencement income of the business can also be netted out with pre-commencement expenses, inter-alia to avoid taxes.

However, the above financial practices are not in accordance with the income-tax Act. The AO should ensure that the measurement and quantification of fixed assets is in accordance with Section 43(1) of the Act, which defines "Actual Cost". Actual cost includes cost price of the assets and all expenses directly relatable to acquisition of asset, and the expenses necessary to bring the asset in to use by the assessee. Pre-commencement interest on borrowed capital, has to be capitalized. For tax purposes, interest is treated as an allowable business deduction, as long as it is incurred in respect of capital borrowed and used for business.

The proviso to Section 36(1)(iii) of the income-tax Act stipulates that: "Provided that any amount of the interest paid, in respect of capital borrowed for acquisition of an asset *for extension of existing business or profession* (whether capitalised in the books of account or not); for any period beginning from the date on which the capital was borrowed for acquisition of the asset till the date on which such asset was first put to use, shall not be allowed as deduction." The phrase *for extension of existing business or profession* has been omitted with effect from 1.4.2016.

Further, in case, the asset is financed by loan in foreign exchange (FOREX), any increase in liability, on account of depreciation of Indian Rupee for acquisition of fixed assets, has to be included in the actual cost as capital expenditure. Correspondingly, where costs have been met directly or indirectly by the Central or State Government or any authority established under any law or by any other person in the form of subsidy or grant or reimbursement, *pro-tanto* amount of subsidy is required to be reduced from actual costs [Explanation-10 to S.43(1)]. Likewise, MODVAT (now GST) on capital assets allowed under Central Excise Act (GST Act) is to be excluded from actual cost in view of restriction imposed on claiming depreciation on the value of MODVAT. Instances have been discovered where the assessee has availed double benefit on fixed assets *viz.* MODVAT on capital goods and depreciation on value of MODVAT.

6.1.2 Intangible Assets: Depreciation is also admissible on intangible assets *viz.*, know-how, patents, copy-rights, trade marks, licenses, franchises, brand or any other business or commercial rights of similar nature being intangible assets, acquired after 1-4-1999. We have Income Computation & Disclosure Standard for tangible fixed assets as ICDS-V. However, difference of opinion is bound to arise. The intangible assets are included in the Balance Sheet, to obtain higher finance, and avoid take-over through an under-valued Balance Sheet. Therefore the intangible asset is recognised at cost when purchased individually,

and at fair value when purchased as part of the acquisition of a business separate from goodwill. Since recognition of intangible assets affects liability side of Balance Sheet as well, the AO should ensure proper valuation of intangible assets. This has also a bearing on depreciation and computation of taxable income.

6.2 Addition to Fixed Assets: Addition to fixed assets is also reflected in schedule of fixed assets to Balance Sheet. The AO should examine whether addition to fixed assets are in the nature & character of current repairs as covered by Section 31 of the income-tax Act,1961 or alternatively is of a capital nature, eligible for depreciation *u*/s 32 of the Act.

6.3 Reduction in Fixed Assets: Fixed assets, can be classified into depreciable assets and non-depreciable assets. Land and motor cars manufactured outside India (except for specified purposes) are non-depreciable assets, as per Section 32 of the I.T. Act. For depreciable fixed assets reduction in value has, twin effects *viz.* - (i) reduction in block of assets by sales consideration and thereby resultant reduction in depreciation; and (ii) working of short term capital gain, *u*/s 50 of the Act. Moreover, w.e.f. 1.4.2000, by amendment in Section 45 (1A), any profits or gains arising from insurance money on account of destruction or damage of any asset due to either convulsion of nature or action of men, is now taxable.

6.4 Amalgamation/ Merger/ De-merger: Fixed Assets, acquired in amalgamation/ merger require detailed examination, as to whether the provisions of lock-in period of 8 years in the scheme of merger/ amalgamation have been complied with. After the effective date of amalgamation/ merger, the depreciation is to be allowed to amalgamating company. Moreover, provisions of Section 45 (Capital gains) are also attracted in case of violation of restrictive conditions of Sections 45, 47A, 49, 50 & 50 A & 50 B of the Act.

6.5 De-merger: De-merger in respect of Companies has been defined in Sub-Section 19 AA of Section 2 of the Act, and means the transfer of one or more undertaking pursuant to scheme of arrangements *u*/s 391 to 394 of the Companies Act 1956. The cumulative conditions stipulated in Section 2(19AA) with other related provisions of the Act require detailed examination by the AO. It is also stipulated that cost of capital asset to the resulting company shall not exceed the WDV of such assets in the hands of demerged Company. Therefore book value as per Balance Sheet, and WDV as per IT Act needs to be examined in depth, for correct computation of taxable income.

6.6 Depreciation: Tax-planning through "depreciation" is a common practice, because of favourable treatment of depreciation in the IT Act *vis-á-vis* the Companies Act. Under the Companies Act, depreciation is provided on days basis. Therefore, book depreciation is always less than depreciation under the IT Act. Many assessees use "depreciation devices" as their tax-planning tool. Again, higher depreciation than strictly permissible under the I.T. Act may be charged during profitable years and such excess may be written back during lean years to "smoothen out" the profits. A shift in the depreciation policy from WDV method to straight line method (SLM) is also used to adjust book profits, to defeat provisions of Sections 115 JA/ 115 JB of the Act.

6.6.1 There are two methods of depreciation in the IT Act.

i. Straight line method (SLM)–for power units: Depreciation can be claimed by power units on SLM at the rates prescribed in Appendix 1A to I.T. Rules. The aggregate depreciation cannot exceed the actual cost. Alternatively, power units can also claim depreciation on WDV basis, after exercising option before the due date of furnishing return of Income.

ii. Written Down Value (WDV)-for other units: For all other assets, the only method available for claiming depreciation is written down value and not SLM [Section 32 (1) (ii) of the Act].

6.6.2 The depreciable assets have been classified as "block of assets" u/s 2(11) of the Act. As per Section 2(11) of income -tax Act, 1961 block of assets means a group of assets falling within the same class of assets it contains;

a. Tangible assets, being buildings, machinery and plant or furniture

b. Intangible assets, being know how, patent, copyrights, trademark, license and franchise or any other business.

The rate of percentage of depreciation is prescribed in the I.T. Rules. A block of assets includes assets of all units of assessee having same rate of depreciation. The AO must classify the schedule of fixed assets into various blocks as required u/s 2(11) of the Act.

6.6.3 Instead of providing depreciation on the basis of days (as under the Companies Act 1956), depreciation under the IT Act is admissible at full rate, if the asset has been used for 180 days or more, and half rate if it has been used for less than 180 days. Therefore, AO should examine the correct date when a depreciable fixed asset was first put to use.

6.6.4 The Written Down Value of block of assets is to be worked out as per Section 43(6) of the Act, for each year.

6.6.5 The assessee may be a beneficial owner of the asset, used for the purpose of business and need not be legal owner. In such circumstances, a lessor is allowed depreciation though the leased assets may not be used by the lessor. The AO should also examine the transactions of SALE & LEASE BACK, to check the misuse of depreciation provisions. Likewise, in Hire-purchase transaction, the hire purchaser is allowed depreciation.

6.7 Mis-use of Depreciation Provisions: While investigating the Balance Sheet in general and fixed assets in particular, the AO should examine the following devices, resorted to by assessees.

6.7.1 Multiple Financing: The source of finance for acquisition of fixed assets, may be own funds, loan funds, lease finance or hire purchase finance or any other mode of financing. Instances exist, in which the assessee uses the same asset as security for obtaining multiple finances, i.e. the asset purchased through term loan, may also be got financed by a Leasing Company, and even through Hire purchase transaction. This is done to finance other activities for which funds are not available from Bank. AO should therefore, examine allow ability of depreciation to the right assessee, and the allow ability of interest expenses as revenue expenditure.

6.7.2 Existence/ Genuineness of Depreciable Assets on which Higher Rate of Depreciation is Allowed: As per provisions of IT Act , there are many assets on which depreciation is allowed at higher rate such @50% or @ 100% such as, Windmills, gas cylinders, pollution control equipments, temporary wooden structures, etc. Therefore, investigation regarding existence of such assets becomes necessary. In cases of large claims of such depreciation, survey on the limited point for verification of fixed assets may be carried out by AO. Usually, in the years of high profitability, assessees may plan acquisition of assets eligible for 50% or 100% depreciation. In leasing transactions, instances have been noticed, where entirely false depreciation claims was made, though no physical asset existed, or was put to use.

6.7.3 Excess Claim of Depreciation: Instances also exist, where the assessees, having taken MODVAT on capital goods, also claimed depreciation on total cost including MODVAT.

6.7.4 Multiple Dip: This means claiming depreciation by more than one assessee on the same asset, *inter-alia* by misuse of various provisions of laws. To illustrate, an asset obtained through Lease financing can be used by the Lessor to claim depreciation, and by the Lessee treating it as acquired through hire-purchase finance. AO should therefore examine the legal/ contractual documents and cross – verify the transactions with each party. Moreover in cross-border transactions multiple-depreciation in the form of "multiple dip" can be structured to generate super profits, in tax-haven countries.

6.7.5 Off-Balance Sheet Fixed Assets: In a typical lease transaction, the Lessee is not required to show leased asset on it's Balance Sheet, which is shown "on Balance Sheet" by the Lessor. Therefore, in the Balance Sheet of Lessee, the lease transactions are declared in notes to the account. The AO should therefore examine the notes to Accounts, for allowing lease rentals, as revenue expenditure. In case of purchases of windmills and cylinders, instances have been noticed that the same asset has been given on multiple-leases, sub-leases, etc and eventually, the aggregate depreciation claimed by different assessees exceeded the cost of asset. The common practice is to take an asset on lease in years of super profits from group companies and pay high lease rentals to loss-making group company or associate company, to smoothen out the group taxable income.

6.7.6 Tax Deferment: A limitation of eight years has been stipulated for carrying forward of depreciation as per Section 32 (2) of the Act. Since, the introduction of Section 115JA/ JB (minimum alternative tax), many corporate are changing their book depreciation policy, *inter-alia* to get around these provisions.

6.7.7 Capital Expenditure *vs.* Revenue Expenditure: Cost of fixed assets can be inflated for higher depreciation claims. If there are reasons to suspect that assets have been over-valued, the assessee should be asked to produce satisfactory evidence in support of the cost price shown. Some assessees debit to their revenue accounts, the salary and expenses of staff engaged in construction work over new units, because in that manner the assessee gets an immediate deduction for that part of the cost, rather than getting it as depreciation over a number of years. This aspect may be looked into when a new unit is being setup. Some assessees recover the cost of fixed assets from customers in one manner or the other. For example, in the case of electricity undertakings, bulk of the cost of the service line is recovered from the consumer and this aspect should be kept in mind, while examining the claim of depreciation.

6.8 Capital Work-in-progress (CWIP): Capital work-in-progress (CWIP) is considered part of the fixed assets, and is required to be presented in the Balance Sheet under the head fixed assets as a sub-head. The CWIP includes, specific fixed assets under construction, and unallocated expenditure during the construction period. CWIP also includes, advances on capital account.

6.8.1 Usually, no detailed investigation of CWIP is carried out at the time of first assessment of a new undertaking/ enhancement of capacity of an undertaking. For the purpose of Sections 68, 69, 69A to 68D, proper investigation of CWIP is essential, as many a times, promoters invest their unaccounted money in the project at the outset and thereafter, the same is given a colour of loan/ debentures/ bridge finance/ subsidy, etc. Normally no loan is available unless margin money from 10% to 25% of cost of project is brought in by the promoters, which gets reflected in CWIP. Moreover, compliance of provisions of TDS on CWIP expenditure should be examined. Further, by analyzing the CWIP, the date of setup of business and the date of commencement of commercial production can be conclusively established for examining claims of depreciation, as also deductions under chapter VI-A. Since other fiscal incentives, eg. subsidy, sales tax exemptions/ deferment, etc. are also available to industries, co-relating conversion of CWIP to Fixed Assets, is of importance.

7. INVESTMENT

7.1 Part I of Sch.VI to the Companies Act, 1956 requires that investments should be distinguished as:

i. Investment in Govt. or trust securities

ii. Investment in shares, debentures or bonds in subsidiary Companies.

iii. Immovable properties

iv. Investment in capital of Partnership firms.

It is necessary to indicate the nature of investment, the mode of valuation *viz.* cost or market value, the break-up of quoted and unquoted investments, and whether these are held as stock-in-trade.

7.2 Disclosure Requirements: Accounting Standard-13 (AS-13) defines investments as assets held for earning dividend, interest and rentals, or for capital appreciation, or other benefits to the enterprise. Assets held as stock in trade are not investmentsAS-13 defines current investment as an investment which is readily realisable and is intended to be held for not more than one year. Other investments are defined as long term investment.

7.3 Revaluation of Long Term Investments: When investments are classified as long-term investments and current investments, it is appropriate to revalue the long-term investments like other fixed assets. Surplus arising out of revaluation is credited to owners' equity as revaluation surplus. If there is any subsequent decrease in the value of long term investments which were previously revalued upward, such decrease is required to be offset against revaluation reserve. In all other cases, revaluation loss is directly charged to profit and loss account. AO should verify the transactions, directly credited to Balance Sheet and not to Profit & Loss Account. If the earlier revaluation loss was charged to profit and loss account, the subsequent revaluation profit will also have to be credited to the profit and loss account.

7.4 Income from Investments: The AO should see that income from various investments has been properly accounted for. It may be pointed out that the profit realized on sale of shares and securities would be capital gain, if the seller is an ordinary investor realizing his holding, but it would be revenue receipt, if he is carrying on a business in shares and securities.

7.4.1 At times, in order to introduce cash in books, an assessee may show sale of a few investments, even though such sales may not have actually taken place. It is, therefore, necessary to check the genuineness of sales, where doubts arise. Some assessees acquire shares in large companies at rates higher than the market rate, to gain effective control over the management of such company. In such cases, inquiry should be made as to whether there was any agreement with the persons presently in control, for acquisition of managing, selling or purchasing agencies of the companies whose shares have been purchased. If so, the AO should make a proper allocation of the total consideration and treat only the amount equal to the market value of the shares as their cost, and the balance as capital payment for the rights of control etc.

8. RECEIVABLES

8.1 Sundry debtors" includes the amounts due in respect of goods sold or services rendered and other contractual obligations but does not include loans and advances.

8.2 Basic classification of sundry debtors is on age-wise analysis, i.e. whether they are outstanding for six months or more than six months. In cases of Companies, disclosure is based on security and recoverability. Separate particulars of Sundry debtors need to be given, classifying:

- Debts considered good in respect of which the company is fully secured.

- Debts considered good for which the company holds no security other than the debtor's personal security.
- Debts considered doubtful or bad.

In cases of Companies, details of related-party debts and the maximum amount outstanding during the year, are also required to be disclosed.

8.3 The provision for bad and doubtful debts is required to be reduced from the sundry debtors. The provision should not exceed the amount considered doubtful or bad. The AO should examine the claim of bad-debts, and also find if there are any recoveries out of bad/ good debts, in cash/ otherwise, outside the books, while debtors continue appearing in Balance Sheet. AO should also take note of the observations of auditors that balances out-standings of debtors/ creditors are subject to confirmations by parties, and if necessary, invoke Section 68/ 69 of the Act.

9. LOANS AND ADVANCE

9.1 Although loans and advances may not be in the nature of current assets, yet Part I of the Schedule VI of the Companies Act, includes "Current Assets, Loans and Advances". Loans and advances in the case of Companies, are classified as:

i. Advances and loans to subsidiaries;

ii. Advances and loans to partnership firms in which the company or its subsidiary is a partner.

iii. Bills of exchange

iv. Advances recoverable in cash or kind or for value to be received i.e. rates, taxes, insurance etc.

v. Balances with customers, port trust, etc. (where payable on demand).

9.2 Investigations of Sundry Debtors, Loans and Advances

The balances in the accounts of various debtors may be shown as a consolidated item under the head "Sundry Debtors". The AO should obtain detailed lists of sundry debtors and advances. Sometimes the balances with the creditors are adjusted from the total of debtors' lists. Where balance in creditors account is deducted it should be seen whether there are accounts of fresh credits during the year. In such cases, the nature of the credits would require scrutiny. Where the debit balances are particularly heavy, they may give clue to the existence of side or branch business and sustained enquiries may be necessary. The AO should also verify that interest realized from debtors has been properly adjusted to the Interest account.

9.2.1 Where the capital is shown as invested, almost wholly or substantially, with one single party, enquiries should be made to find out assessee's connection with the said party. Sometimes the assets side of the Balance Sheet may be found to include a large debit balance shown as due from one debtor. The amount shown as outstanding may be almost the same as the capital employed in the business. Normally, a trader is not likely to take such risk by parting with his capital and keeping it with one single outsider. The possibility that the alleged debtor may just be a *benami* concern or a branch business or otherwise connected with the assessee, should not be lost sight of.

9.2.2 Many times, when assessees experience shortage of cash balance in cash book, they show cash sales/ cash payment from debtors, to overcome provisions of Section 269SS/T of the Act.

9.2.3 Many a times income are not shown in P& L account but are directly credited as receivables to the Balance Sheet such as MODVAT receivables, insurance claims etc. Netting of creditors with debtors are resorted to with a sole purpose to thwart investigation of sources of funds/ bogus creditors by the department.

9.3.4 The transactions of "FACTORING' (selling of debtors by the assessee for cash)

and "FORFAITING" (selling of medium term receivables for cash) , also need to be analysed, to find out whether they are genuine transactions or not.

9.3.5 The AO may work out total debtors account and check the total cash received from debtors to see whether any cash credit is introduced in the garb of realisation of debts.

10. INVENTORIES

Inventories comprise of following items -

- Stocks of raw materials
- Stocks of work-in-process
- Stocks of Finished goods/ stock-in-trade
- Spares & Stores, loose tools
- Goods-in-transit.

Disclosure Norms require that, the basis of valuation of inventories, as also quantitative details of licenced capacity, installed capacity, opening stocks, purchases, production of finished goods/ by-products, sales and closing stock, are disclosed. Valuation of inventories is covered by ICDS-2.

10.1 Valuation of Inventories: The valuation of closing stock has a direct bearing on profits. In the case of a trader, the closing stock will be of the commodity or item that is dealt in. In the case of a Manufacturing concern, the closing stock will comprise of raw materials, stock in progress, finished goods and by-products. In case of concerns engaged in construction work, there will be "Work-in-progress." The stocks can be valued either–at cost; or at market rate; or at cost or market rate whichever is lower. Market value means the price at which the goods could be purchased by the trader in the market. Where, however, stock-in-hand has become damaged, such stock can be valued at the figure representing the price at which it can be sold.

10.2 Important Points Regarding Valuation of Stocks

10.2.1 The question of valuation of stock-in-process arises in the cases of manufacturing concerns. Stock-in-process includes the material used in the process of manufacture, and semi-finished material, lying on the machines. In the case of textile mills it would include the cotton in the blower room, the cotton or yarn on the spindles, the yarn and cloth on the looms and so on. Since the stock-in-process is converted into a finished product, its value is more than the value of the raw material because some money has been spent on its processing. The AO should examine the list of stock-in-process and see whether the rate adopted from stage to stage is commensurate with the value of the raw materials and the processing expenditure.

10.2.2 Some concerns write-off a percentage of the value of finished goods, if the goods are not sold for a certain length of time. This percentage is progressively increased if the goods have been in stock for a longer period. This is a rough and ready method of determining the market value of goods which are not fast-moving, and provides scope for manipulating the value of closing stock.

10.2.3 Section 145A of the Act, requires inclusion of any tax, duty, cess, excise etc. in the valuation of stock and sales & purchase of goods. The AO may also examine whether ICDS-2 is complied with. Any change in method of valuation of inventory has to be examined in detail by AO to determine the true taxable income of the assessee. The Supreme Court, in *CIT vs. British Paints India Ltd*. (1991) 188 ITR 44 (SC), has held that, any system of accounting which, for valuation of the stock, excludes costs other than the cost of raw materials for the goods in process and finished goods, is likely to result in a distorted picture of the true state of the business.

10.2.4 Valuation of a capital asset when converted into stock-in-trade, is to be done at

market price. In the event of dissolution of a firm, valuation of stocks is to be carried out at "market price" only, as held in the case of *ALA firm vs. CIT*, 189 ITR 285 (SC).

11. CASH & BANK BALANCES

In the Balance Sheets of a Company, cash in hand as also cash with scheduled bank and non scheduled bank and post office, is to be shown separately. This is mainly to indicate safety of funds, and any related-party interest, in maintaining such balances with a non-scheduled bank.

12. MISCELLANEOUS EXPENDITURE

Miscellaneous expenditure is shown in Balance Sheet to the extent not written off or adjusted. It is classified as under -

- Preliminary expenses;
- Expenses including commission or brokerage on underwriting or subscription of shares and debentures.
- Discount allowed on the issue of shares or debentures;
- Interest paid out of capital during construction (also stating rate of interest)
- Development expenditure not adjusted
- Other items (specifying nature)

13. DEFERRED REVENUE EXPENDITURE

Deferred Revenue expenses are shown under this head separately and written off over a period of 3–5 years. ICAI "Guidance Notes on terms used in the Financial Statements" defines "deferred revenue expenditure", as the expenditure for which payment has been made or a liability incurred but which is carried forward on the assumption that it will be of benefit over a subsequent period or periods.

13.1 Some important indications (as contained in various documents of ICAI) for identification of certain transactions/ events as "deferred expenditure" are given below:

i. Compensation agreed upon to terminate the services of employees under voluntary retirement scheme can be treated as deferred expenses and written off over a period of 5 years or earlier. But, gratuity, pension, and other retirement benefits, which constitute the termination expenditure payable otherwise than on premature termination, should not be treated as deferred expenditure.

ii. Para 10.1 of the statement of Auditing Practices explains that "If a future period will receive benefit from the outlay, the proper portion of the deferred charge should appear on the Balance Sheet…."

iii. Debenture discount or debenture issue expenses should be written off over the maximum period for which the debentures remain outstanding. In general deferred expenditure should be written off over a period of 3–5 years.

iv. Preliminary expenses normally include legal costs in drafting the Memorandum and Articles of Association, Capital duty and other fees on registration of the company. Cost of printing, Memorandum etc, and any other expenses incurred to bring into existence the corporate structure of the company.

v. Indirect expenses incurred during the construction period, which do not have any connection with the construction, cannot be capitalized. These expenditure can, however, be treated as "deferred revenue expenditure" and written off over a period of 3–5 years after the commercial production commenced.

vi. Special advertisement expenses for launching a new product can be treated as deferred expenditure.

Normally, above expenses are capital in nature, but income-tax Act treats some of these expenses as revenue expenditure to be allowed as deduction by way of amortisation of preliminary expenses u/s 35 D of the Act.

14. LIABILITY SIDE

Liability side of a Balance Sheet has following groupings:

- Capital
- Reserves & Surplus
- Secured Loans
- Unsecured Loans
- Current Liabilities & Provisions.

Capital Structure of Companies

14.1 Types of Shares: Companies can issue two types of shares, namely, equity shares and preference shares. Preference share capital of a company means the share capital that carries preferential right as regards dividend as well as repayment of capital including premium, if any, on winding up. It will be deemed to be preference share capital although there is a right to participate in surplus as regards dividends or repayment of capital on winding up in addition to the preferential right as regards dividend/ repayment of capital on winding up (Section 85 of the Companies Act). Equity share capital means all share capital which is not preference share capital.

14.2 Altering Share Capital: A company can alter its share capital by (a) Issuing new shares, (b) Consolidating and dividing all or any of its share capital into shares of larger amount, (c) Converting all or any of the fully paid up shares into stock and reconverting stock into fully paid up shares of any denomination, (d) Cancelling shares (Section 94 of the Companies Act), (e) Buy-back of shares, (f) Call-option/ put-option rights.

14.3 Bonus Shares: In case of issuance of bonus shares, details of shares held (i) by directors, and (ii) by others, is to be disclosed. Besides, the source from which bonus shares are issued is to be indicated. It may be from free reserves, realized capital profit (excluding revaluation reserve, which is not realised as capital profit) or from share premium account balance.

14.4 Particulars of 'options', if any, on unissued share capital are to be given, Para 8.11 of the statement on Auditing Practices (Third Edition, ICAI) explains that an option on shares arises when a person has acquired a right under an agreement with the company to subscribe for shares in the company, if he so chooses.

14.5 Share Application Moneys: Until allotment is made any amount received by the company against issue of shares should not be shown as "Subscribed Capital". Share application moneys and call money received in advance, require to be transferred to Share Capital account in due course , except in two situations, should be shown between "Share Capital" and "Reserves and Surplus". Two exceptions are (a) invalid or revoked applications and (b) excess application moneys received due to over- subscriptions which should be shown under "Current Liabilities". Any refunds due against the rejected share applications should be shown under the head "Current Liabilities and Provisions "

14.6 Redemption of Redeemable Preference Shares: A company can issue redeemable preference shares which are redeemable within a period of ten years from the date of issue. Only fully paid-up preference shares can be redeemed. A Capital Redemption Reserve is to be created if the redeemable preference shares are redeemed out of balance of Profit and Loss account or balance of free reserve. The capital Redemption Reserve can be utilised for issuing fully paid-up bonus shares

to the extent of unissued share capital of the company.

14.7 Conversions: Presently, many new innovative Debt instruments have emerged in the capital market. Many such debt instruments include convertible Clauses. If a company issues fully/ partly convertible debt instruments, it is necessary to disclose by way of notes, the particulars of the conversion and effect of the conversions on the future capital structure of the company for transparency.

14.8 Conversion of Partnerships into Companies: In case of non-corporate entities, detailed analysis of movements in capital accounts is necessary. Often, with a view of avoid stamp duty, capital gain etc., partnership firms are converted into Part IX Companies (Part IX of the Companies Act) and large amounts are credited in partners' capital account, as issue of shares for non-cash items, through revaluation of assets.

14.9 New Share Capital: In the case of companies, the AO should carefully examine the total amount of 'paid up' capital and shares issued for consideration other than cash. For the first assessment year (and subsequently when there is accretion to capital), the AO should obtain details about the subscription of capital with names, addresses and amounts, and pass the same to the AO having jurisdiction, for enquiries whether the persons in whose names shares have been allotted are genuine shareholders or benamidars for somebody else. A list of shareholders thus obtained, will give an idea as to the real persons controlling the affairs of the company. If there is a suspicion about introduction of nominees, the AO may study the applications made by such shareholders, and also examine the manner of payments made by the subscribers. Sometimes a uniform handwriting on all application forms may provide some clue, after which a detailed probe may be necessary to show that the shareholders are not genuine.

14.10 Shares-in-kind: Shares are sometimes allotted by companies for consideration other than cash. The break-up of Paid up Capital and the number of shares issued as fully paid to vendors and others for consideration other than cash, pursuant to contract, will show persons who are interested in the company and may reveal controlling interest. Foreign companies are sometimes allotted shares in consideration of supplying technical know-how, plant and machinery etc. The question of taxing the profit element on the sale of such plant and machinery and supply of the technical know-how should be carefully considered. When the company has raised capital, it should be seen that expenses connected therewith are disallowed.

14.11 New Financial Instruments-Deferred Capital: In the era of liberalization, new financial instruments for financing business operations have been introduced such as -

- Warrants
- Convertibles
- Stock Option to Employees/ Directors
- Derivatives
- Buy-Back of Shares
- Stock – Splits
- Global Depository Receipts [Gdr/ Adr]
- Stock – Dividends
- Optionally Convertible Debentures
- Perpetual Non-Convertible Debentures ("PNCDs") or Hybrid Bonds,

At the time of issue of some of the above instruments, no cash in-flow is received by the company, but cash (conversion in to share capital) is received at later date. The question as to whether the expenditure incurred for issuing/ converting these instruments is CAPITAL OR REVENUE is also to be examined by AO.

14.12 Capital introduction-Section 68: The increase in capital is normally invested

by investors/ promoters. Instances have been noticed, where promoters used following devices for introducing unaccounted income in the guise of share capital, and where provisions of Section 68 were applied -

- Bogus NRI gifts
- Global Depository Receipts/ American Depository Receipts
- Under-invoicing/ valuation of import and over-invoicing of exports to misuse VABA L (Value-Based Advance license) & QABAL (Quantity-Based Advance license)
- Introduction of Share Capital through Bogus/ Paper companies

The AO should in case of need take help from the Foreign Taxes Division (FTD), of CBDT to investigate the genuineness and veracity of NRI/ NRE Gifts, and "Hawala" transactions. Moreover, GDR/ ADR issues are also used as money-laundering devices. Generally, there is a scramble to buy new issues of GDRs, as they are quoted below par. They are largely bought by the foreign nominees of the same company. In this manner, black money is converted into white. Later, such deposits are converted into shares. By examining the trend of share prices in the share market, the AO may investigate the company as also the promoters in detail because instances have been noticed where promoters have used their unaccounted money for "PRICE –RIGGING" in the share markets.

14.13 Building Capital through Circular Transactions: In an era of booming capital market and control of public issues by SEBI, corporate assessees often resort to the device of building share capital through circular transactions of shares and corresponding amount of paper transactions of loans & advances. It is necessary to examine the genuineness of such circular transactions, so as to find out correct capital, and to disallow interest claims.

14.14 Introduction of Share Capital through Bogus/ Paper Companies: Routing the unaccounted income back to the books of account disguised as loan or share capital is widely used by the tax evaders. The process to bring the money back in this manner is commonly known in business parlance as *Jamakharchi entries* or *accommodation entries*. This is a well organized racket controlled and conducted by persons known as *entry providers*. Investigation wings of Kolkata, Mumbai, Delhi, Ahmedabad and of other cities as well have, from time to time, conducted search and seizure operations against such entry operators. There are data base of such entry operators and companies operated by them with these Investigation Wings. The AO may also get assistance of the respective Investigation Wings, if the volume or amount of such transactions is found to be substantially high.

14.15 Perpetual Non-Convertible Debentures ("PNCDs") OR Hybrid Bonds: Of late, a number of large companies and banks are issuing "Perpetual Bonds". These bonds are also listed on NSE/ BSE under the debt segment. The AO needs to carefully examine the issue of allowability of interest payment of these bonds in view of typical nature of the perpetual bonds which is akin to equity.

Perpetual bonds are the bonds with no maturity date. Which means the investor (bondholder) do not get the right to redeem the bonds at any point of time. Only the issuing company can take back i.e. buy back the bonds from the investors. Thus the call option is with issuer and not the investor which makes it different than the debt or borrowing because in the case debt or borrowing the authority and right to call vests (even if it is dependent on certain conditions) with the payer. To indemnify the fact that the bond holder can normally not redeem their investment – the issuer company pays higher returns to the investors. Once the bond is sold,

the rights of future profit and benefits passes to the new bond owner.

The main purpose of issuing perpetual bond is to show a healthy Balance Sheet with better debt to equity ratio and better profit. Normally, the accounting treatment of perpetual bond and interest pay out on the same is as under:

i. The amount of perpetual Bonds is not shown in the Balance-Sheet of the assessee as debt or borrowing. It is shown below share capital and above non-current & current liabilities.

ii. The returns (interest) on Perpetual Bonds is not charged to Profit & Loss account under Financial cost.

iii. The return is taken as post-profit distributions in the financials that *prima facie* signifies that it is application of profit or income.

Hence, from the accounting treatment given to this transaction *prima facie* its appears that the Perpetual Bonds are in fact equity in disguise. Moreover, the interest pay out or return on perpetual bonds can therefore be claimed only in the computation of income separately. Since this pay out is reduced after post tax profit like dividends, this itself *prima facie* shows that the characterization of the perpetual Bonds in the books of assessee is akin to equity.

Thus, *prima facie* the interest payment on such perpetual bond should not be allowable as expenditure. The AO should study the terms and conditions for issuing such bonds to arrive at conclusion as to allowability of interest on the same as business expenditure.

15. RESERVE & SURPLUS

15.1 Reserves are classified into (i) Revenue reserve, and (ii) Capital reserve. 'Guidance note on terms used in Financial Statements' issued by the ICAI defines "Reserve" as the "portion of earnings, receipts or other surplus of an enterprise (whether capital or revenue) appropriated by the management for a general or specific purpose other than a provision for depreciation or diminution in the value of fixed assets or for a known liability. "Capital reserve" is reserve, which is not available for distribution of dividend. Revenue reserve is any reserve other than capital reserve. Profit on sale of fixed assets and investments are considered as revenue reserve since such profit is credited to profit and loss account, as per provisions of Companies Act and prevailing practices.

15.2 Types of Reserves and Surplus: Reserves/ surplus are classified as follows:

i. Capital Reserve

ii. Capital Redemption Reserve.

iii. Share Premium Account.

iv. Other Reserves specifying the nature of each reserve and the amount in respect thereof.

v. Surplus, i.e. balance in profit and loss account after providing for proposed allocations, namely , Dividend, Bonus or reserves

vi. Proposed additions to reserve

vii. Sinking Funds

15.2.1 Share Premium Account: Details of the utilisation of the balance of the share premium account are to be given. The manner in which this is to be utilised, is specified in Section 78 of the Companies Act. This balance can be used for - (i) paying up unissued shares of the company as fully paid up bonus shares, (ii) writing-off the preliminary expenses, (iii) writing-off the balance of commission/ discount allowed/ paid on issue of shares/ debentures, (iv) providing for the premium payable on the redemption of preference shares. AO should therefore examine the utilization especially, for ascertaining liability u/s 41 of the Act.

15.2.2 Sinking Fund: The word "fund" can be used after a reserve only if there is a specific

investments against such reserve. Therefore, there must be specific investments against the sinking fund.

15.2.3 Taxation Reserves: Reserves like investment allowance reserve, development allowance reserve (for tea companies), foreign project reserve/ export incentive reserve, foreign exchange earning reserve, etc., created as per income-tax Act, are required to be maintained for a specified period. So long the specified period is not over, such reserve cannot be treated as free reserve for the purpose of distribution of dividend without additional tax liability. If any transfer is made from such reserves without complying with the requirement of the income-tax Act, the AO should invoke requisite income-tax provision.

15.2.4 Subsidy Reserve: If Government grants are received against capital assets, it is possible to follow gross approach for accounting purpose. Under the gross approach, the fixed assets are shown at cost and the related grants/ subsidy is transferred to Subsidy Reserve.

15.2.4 Revaluation Reserve: In case of revaluation of fixed assets if there is a net gain, such gain is transferred to Revaluation Reserve. It is not permissible to issue bonus shares out of revaluation reserve. It is a common practice to take transfer from the Revaluation Reserve for the additional depreciation charge arising out of revaluation.

15.2.5 Debenture Redemption Reserve (DRR): It is a reserve created for redemption of debentures at a future date. It is necessary create DRR in terms of Section N of the SEBI Guidelines for Disclosure and Investors Protection (issued on 11.06.1992).

15.3 Examining Reserves: The Reserve account should be examined to see how it was created and whether there has been any appropriation out of the reserve. Reserves created out of Profits & Loss Account are obviously not an admissible deduction. The various accounts for reserves should be checked to see what amounts have been added or withdrawn during the year. Sometimes the reserves might be directly credited by debiting certain accounts like sales, interest etc. Copies of Reserve accounts should, therefore, be obtained and the credits and debits should be carefully scrutinized. Debits to the reserves should be studied with reference to their purpose.

Sometimes the value of the assets may be written down and decrease adjusted against reserve account. Similar will be the position with regard to appreciation. Sometimes this adjustment is directly done through reserve account and will appear in the Balance Sheet without being reflected in the Profit & Loss account.

It is in relation to current assets that the dangers of secret reserves are greater. Matters such as over-provision for doubtful debts, excessive writing-down of stocks, over-provision for liabilities and writing off of stores, present a difficult problem because these manipulations will materially distort the statement of profit without any disclosure of what has been done. It should be seen whether the provision in respect of liabilities, writing-down of stocks etc. has been done in a reasonable manner.

The AO should also examine the transactions in Share forfeited a/c and consequent creation of reserve in view of the decision of the Hon'ble Supreme Court in the cases of *CIT vs. T.V. Sundaran Iyengar & Sons Ltd.* 222 ITR 344 (SC) and CIT vs. Karamchand, Thapur, 222 ITR 112 (SC) that - "The principal amount initially not received as trading receipt can become trading receipt subsequently". Further any profit/ reserve related for pre-incorporation period of Company is not assessable as income in the hands of the Company as Company doesn't exists before its incorporation (*CIT vs. City Mills Distributors Pvt. Ltd.* 219 ITR-1 (SC).

16. SECURED & UNSECURED LOANS

16.1 SECURED LOANS: Loans secured wholly or partly against an asset is secured loan. Where the value of the security falls below the amount of loan, the loan becomes partly secured. Unsecured portion of that loan should be classified under the head " Unsecured Creditors". Secured loans are classified as follows:

i. Debentures

ii. Loans and Advances from banks.

iii. Loans and Advances from Subsidiaries

iv. Other Loans and Advances

16.1.1 Loans and Advances from Banks: Secured overdraft from banks (like overdrafts secured by hypothecation of stores, stock-in-trade and book debts and guaranteed by another company) is classified under the sub-head "Loans and Advances from Bank".

16.1.2 Loans from Directors and managers should be shown separately. AO may apply provision of Section 2 (22) (e) of the IT Act in appropriate cases. If the Loans are guaranteed by the directors or managers, it is required to mention the guarantee and the amount of loan under each head. Nature of Security also needs to be specified.

16.1.3 If the assets are mortgaged in favour of a third party who guaranteed the loan, such loan should be classified as Secured Loan. The fact of mortgaging the assets in favour of guarantor (instead of favouring the lender) should be disclosed.

16.2 Unsecured Loans: Unsecured loans are those loans which are not secured by mortgage of assets. Unsecured portion of the partly secured loan should be classified as unsecured loans. Unsecured loans are classified as follows:

i. Fixed Deposits

ii. Loans and Advances from subsidiaries

iii. Short term loans and advances - from banks; and from others

17. CASH CREDITS/ BENAMI TRANSACTIONS

17.1 It is obligatory for a Company to specify the nature of the security offered for obtaining a secured loan. Quite often overdrafts from banks and other loans are secured by Directors of the company or by partners of firms. In such cases, the AO having jurisdiction over the Director(s) or Partner(s) must be informed so that he may make appropriate enquiries at his end. Often the assessees take an overdraft from Bank or genuine loans from other parties on the security of investments, stocks or other assets not stated at all or under-stated on the Assets side of the Balance Sheet. The AO has to find out the security for the loan and whether the same is adequately explained with reference to the books of account. Undisclosed income of an assessee may be brought into the books in the names of fictitious persons by way of loans. Often these accounts are squared up before the end of the accounting year and may not figure in the Balance Sheet. Copies of these accounts should be obtained and forwarded to the AO assessing the lenders. If there is any doubt or suspicion, the AO should summon the lenders and examine them before accepting the loans as genuine.

17.2 Disallowance of Interest/ taxes/ duties: On examination of P&L and Balance Sheet along with cash flow statement, AO may examine the applicability of Section 43B, in respect of borrowings from financial institutions and banks, etc. Interests on borrowed funds diverted for non-business purposes, will also have to be disallowed. Repayments of loans also requires examinations regarding compliance with Section 269SS & 269T of the Act.

18. CURRENT LIABILITIES & PROVISIONS

18.1 Current liability includes loans, deposits and bank overdraft which falls due for payment in a relatively short period, not more than twelve months. However, short term secured and unsecured loans are not considered as current liability. Current liabilities are classified as under:

18.2 Acceptance: ICAI Guidance Note on terms used in Financial Statements (Para 1.02) defines 'Acceptances' as "the drawee's signed assent on bill of exchange, to the order of the drawer".

18.3 Sundry Creditors: Sundry creditors are represented by the amount owed by an enterprise on account of goods purchased or services received or in respect of contractual obligations . Sundry Creditors are also called 'accounts payable' or 'trade creditors'. In the common parlance, creditors are classified as trade creditors and expense creditors. So all the outstanding payments on account of goods and services including those are commonly understood, as expense creditors are classified as trade creditors.

18.4 Subsidiary Companies: Any outstanding to a subsidiary company on current account for purchase of goods or services, any advance received from a subsidiary for supply of goods and services, and any other short term due to subsidiaries, which are not in the nature of loans, are classified under this sub-head.

18.5 Advance Payments and Unexplored Discount: Any payments received in advance against which goods are to be supplied or services are to be rendered in short run (i.e. within 12 months), eg., advances from customers, dealers etc.

18.6 Unclaimed Dividend: Para 17.02 of the ICAI Guidance Note on Terms used in Financial Statements, defines "unclaimed dividend" as "Dividend which has been declared by a corporate enterprise and a warrant or a cheque in respect whereof has been dispatched but has not been encashed by the shareholder concerned".

19. PROVISIONS

19.1 The term "Provision" is defined as "an amount written off or retained by way of providing for depreciation or diminution in value of assets or retained by way of providing for any known liability the amount of which cannot be determined with substantial accuracy"

19.2 Provision for Taxation: Some companies adjust advance tax paid against provision for taxation. Others present total provision for taxation under the sub-head "Provision" and the advance tax under the head "Current Assets, Loans and Advances."

19.3 Provision for Provident Fund and other Retirement Benefits: Employees contribution for provident funds, gratuity, pension and other retirement benefit schemes should be provided for on accrual basis.

19.4 Provision for Contingencies: Para 4.1 of AS-4 (Revised) "Contingencies and events occurring after the Balance Sheet date" issued by the ICAI has defined the term "contingency" as "a condition or situation, the ultimate outcome of which, gain or loss, will be known or determined only on the occurrence, or non-occurrence of one or more future events" . Paras 10 and 11 of AS-4 (Revised) suggests to provide a reasonable amount for the contingencies by way of charge to Profit and Loss Account if, it is probable that future events will confirm that, an asset has been impaired or a liability has been incurred. Otherwise, the existence of contingent liabilities should only be disclosed.

19.5 Provision for Loss in the Value of Investments: Sometimes market value of investments of a permanent nature declines. If such decline in the market value is not of the temporary nature, there is a need for providing for such loss.

20. SOME ISSUES RELATING TO INVESTIGATION OF LIABILITIES SIDE

20.1 Sundry Creditors and Loans

i. The Liabilities side of the Balance Sheet should be examined to see whether incomes from undisclosed sources have been directly credited to Personal Accounts (in known names or in the names of benamidars). The AO should be watchful for credit balances in uncommon and unusual names. If a balance is appearing on the Liabilities side of the Balance Sheet in the name of any party for several years an enquiry is called for to ascertain if that balance is genuine or fictitious.

ii. Sometimes fictitious purchases can be detected by examining a Balance Sheet carefully. The inflation in purchases is resorted to by passing credit entries in the personal accounts of some persons, with corresponding debits to the Purchase account. As the credit is fictitious, no payment has to be made against it. As a result such credit balances are carried forward. Therefore, whenever any liability appears in Balance Sheet for a number of years on account of unpaid purchase price, verification should be made.

iii. Another assessee used to deposit surplus money in short-term deposits with banks. Detailed examination of the cash book showed that the assessee had allegedly encashed on a certain date a short-term deposit of Rs. 50,000. A comparison of the books of account with the bank statements revealed that the deposit was still lying with the bank and had not actually been encashed. This indicated that the assessee was keeping monies outside the books of account, which he was bringing into the books as and when necessary.

20.2 Provisions: A break-up of these items should be obtained. If the assessee has got remission of liability, applicability of Section 41(1) of the Act should be examined. Care should be taken to see that contingent liabilities or any over-provision in respect of existing liabilities is not made by debit to P&L Account. If there are any reserve account, *Uchanti* account, Suspense Account and other accounts of like nature, a proper scrutiny of the real sources of important receipts and destination of important payments should be made.

CHAPTER 11

Income Computation and Disclosure Standards

An Accounting Standard (AS) is a common set of principles, standards and procedures that define the basis of financial accounting policies and practices. They are the written policy documents issued by the Government or a regulatory body covering the aspects of preparation and presentation of a financial statement. They are the framework and guidelines for maintaining books of accounts for an organisation.

2. OBJECTIVES OF ACCOUNTING STANDARDS

The primary objective of AS is to harmonize different accounting policies which are used in the preparation of financial reports. The accounting standards are issued to put an end to the non-comparability of financial statements and to increase their reliability. In India, AS are issued under the supervision and control of Accounting Standards Board (ASB). It is a committee formed under the Institute of Chartered Accountants of India (ICAI) consisting representatives from Government department, academicians and professional bodies like ICSI, CII, FICCI etc.

2.1 For Companies incorporated under the Companies Act, 2013, Section 133 of the Companies Act, 2013 has given the powers to the Central Government to prescribe the accounting standards as recommended by ICAI in consultation with and after examination of the recommendations made by the National Financial Reporting Authority. Till the National Financial Reporting Authority is formed, the Central Government, in consultation with National Advisory Committee on accounting standards, has made Companies (Indian Accounting standard) Rules, 2015. As per the said Rules, Indian Accounting Standards (Ind-AS) shall be applicable to certain classes of Companies specified in rule 4.

2.2 For organisations other than those registered under the Companies Act, 2013, AS issued by the ICAI will be applicable.

3. ACCOUNTING STANDARDS UNDER THE INCOME-TAX ACT, 1961 (THE ACT)

Section 145 of the Act, provides that taxable income of an assessee falling under the heads

"Profits and gains of business or profession" or "Income from other sources", shall be computed in accordance with either cash or mercantile system of accounting which is regularly employed by the assessee. It further provides that the Central Government (CG) may notify, from time-to-time, Income Computation & Disclosure Standards (ICDS) to be followed by any class of taxpayers or in respect of any class of income.

3.1 The Central Government vide notification 2 dated 31st March, 2015 has notified 10 ICDS for compliance by all assessees following mercantile system of accounting w.e.f. 1st April, 2015. These ICDS supersede following two standards earlier notified in 1996:

Tax Standard I – Disclosure of accounting policies

Tax Standard II – Disclosure of prior period and extraordinary items and changes in accounting policies.

3.2 Certain key highlights of ICDS, amendments carried out in Finance Act, 2015 at enactment stage and differences between ICDS and existing Accounting Standards (AS) are discussed hereunder:

- ICDS shall apply for computation of income chargeable to income-tax under the head "Profits and gains of business or profession" or "Income from other sources". Accordingly, ICDS has no impact on minimum alternate tax computation for corporate assessees which will continue to be based on 'book profit' determined in accordance with currently applicable AS.
- ICDS is applicable to all taxpayers (corporates/ non-corporate or resident/ non-resident) irrespective of turnover or quantum of income.
- The preamble of each ICDS clarifies that (a) ICDS is applicable for computation of income and not for the purposes of maintenance of books of account; and (b) In case of conflict between the provisions of the Act and ICDS, the provisions of the Act shall prevail to that extent.
- All ICDS (except ICDS VIII relating to Securities) contain transitional provisions which, in general, provide for recognition of outstanding contracts and transactions as on 1st April, 2015 in accordance with ICDS after taking into account income/ expenditure/ loss already recognised in the past periods. Thus, there is no 'grandfathering' for outstanding contracts or transactions as on 31st March, 2015.
- Non-compliance of ICDS empowers Tax Authority to assess income on 'best judgment' basis. Any additions to income declared in return of income may also have potential penalty implications.

4. A comparative list of ICDS notified with effect from 01 April 2015 and comparable AS issued by ICAI is as under:

Sl. No.	ICDS	Comparable AS
1.	Accounting policies (ICDS I)	Disclosure of Accounting Policies (AS 1) Net profit or loss for the period, prior period items and changes in accounting policies (AS 5)
2.	Valuation of inventories (ICDS II)	Valuation of Inventories (AS 2)
3.	Construction contracts (ICDS III)	Construction Contracts (AS 7)
4.	Revenue recognition (ICDS IV)	Revenue Recognition (AS 9)
5.	Tangible fixed assets (ICDS V)	Accounting for Fixed Assets (AS 10) Depreciation Accounting (AS 6)
6.	Effects of changes in foreign exchange rates (ICDS VI)	The Effects of Changes in Foreign Exchange Rates (AS 11)

7.	Government grants (ICDS VII)	Accounting for Government Grants (AS 12)
8.	Securities (ICDS VIII)	Accounting for Investments (AS 13)
9.	Borrowing costs (ICDS IX)	Borrowing Costs (AS 16)
10.	Provisions, contingent liabilities and contingent assets (ICDS X)	Provisions, Contingent Liabilities and Contingent Assets (AS 29)

5. COMPARISON BETWEEN ICDS AND AS

ICDS –I ''Accounting Policies" **Scope:** Deals with Significant Accounting Policies and in Line with AS	**AS -1 "Disclosure of Accounting policies"** **Scope:**Deals with Significant Accounting Policies
Fundamental Accounting Assumption: same as in Accounting Standard -1	**Fundamental Accounting Assumption:** Consistency Accrual Going Concern
Consideration in Selection of Accounting policies: True & Fair view in preparation & Presentation of Financial Statement. For this purpose a. Treatment of transaction by substance not merely by substance legal form b. Marked to market loss or expected loss shall not be recognised unless provided by other ICDS c. Market to market or expected profit shall not be recognised unless provided by other ICDS	**Consideration in Selection of Accounting policies:**True & Fair view in preparation & Presentation of Financial Statement. For the purpose a. Treatment of transaction by substance not merely by substance legal form b. Expected loss shall be recognised as per prudence concept c. Expected gain shall be ignored unless specifically provided by other Accounting Standard
Change in Accounting Policies: Accounting policies shall not be changed without reasonable cause. If Accounting policies changed:Require a. Any material effect shall be disclosed w.r.t to items in financial statements to the extent ascertainable b. If the Above Change is not ascertainable the fact should be disclosed c. If any change is expected to occur in Future due to change the fact should be disclosed in Current FY as well as in FY when first time change occurred	**Change in Accounting Policies:** Accounting policies shall not be changed unless: a. Change is required as per statute b. In compliance of AS c. Better presentation of Financial Statement If Accounting policies changed:Require a. Any material effect shall be disclosed w.r.t to items in financial statements to the extent ascertainable b. If the Above Change is not ascertainable the fact should be disclosed c. If any change is expected to occur in Future due to change, the fact should be disclosed in Current FY as well as in FY when first time change occurred

Disclosures: All the significant Accounting policies Change in Accounting policies **Note:** Any incorrect & inappropriate treatment of item cannot be remedied by Disclosure	**Disclosures:** All the significant Accounting policies Change in Accounting policies **Note:** Any incorrect & inappropriate treatment of item cannot be remedied by Disclosure
ICDS-II "Valuation of Inventories" **Scope:** Deals With Valuation of inventories **Inventory:** Are Assets a. Held for sale in ordinary course of Business b. In process of production of such sale c. In form of raw material & Supplies to be consumed in process of production & rendering services *Measurement of inventories – Cost or net realisable value, whichever is less* **Methods to Valuation:** a. Standard cost b. Weighted average c. FIFO d. Retail cost method **Cost of Purchase of:** a. Includes purchase price b. All the duties & taxes c. Freight & other attributable expenses other than borrowing cost (unless meet recognition criteria under ICDSIX) *Duties & taxes recoverable shall form part of the cost as per Section 145A of income-tax Act 1961* **Applicability of ICDS-II:** Applied for Valuation of inventory except a. WIP arising under construction contract including directly related service contract b. WIP dealt with other ICDS c. Producers inventories of livestock agriculture & Forest products, mineral oils, ores & Gases to the extent they are measures at NRV d. Machinery spares, which can be used only in connection with a tangible fixed asset and their use is expected to be irregular, shall be dealt with in accordance with the income computation and disclosure standard on tangible fixed assets e. Financial instruments held as stock in trade **Note:** Inventory of service provider is also cover under ICDS-II (Not in AS2-). Cost of services shall include the Labor cost and other cost of personnel directly engaged in providing services including supervisory personnel & other attributable overhead	**AS-2 "Valuation of Inventories"** **Scope:** Deals With Valuation of inventories **Inventory:** Are Assets a. Held for sale in ordinary course of Business b. In process of production of such sale c. In form of raw material & Supplies to be consumed in process of production & rendering services *Measurement of inventories – Cost or net realisable value, whichever is less* **Methods to valuation:** a. Standard cost b. Weighted average c. FIFO d. Retail cost method **Cost of Purchase of:** a. Includes purchase price b. Freight, other attributable expenses which is necessary to bring inventory to existing place **Applicability of AS-2:** Applied for Valuation of inventory except WIP arising under construction contract including directly service contract WIP arising in ordinary course of business for service providers Financial instruments held as stock in trade Producers inventories of livestock agriculture & Forest products mineral oils, ores & Gases to the extent they are measured at NRV

Valuation of Inventory in Case of Certain Dissolutions: Dissolution of Partnership firm, AOP, BOI, notwithstanding business continues or not, inventory shall be valued at Net realizable Value **Disclosures:** Accounting policies adopted & Formula used Actual Carrying amount of inventory	**Valuation of Inventory in Case of Certain Dissolutions:** No such provision in AS2- **Disclosures:** Accounting policies adopted & Formula used Actual Carrying amount of inventory

ICDS-III "Construction Contracts"	**AS-7 "Construction Contracts"**
Scope: This ICDS should be applied in determination of income on construction contract of a contractor ⇒ A group of contracts whether with a single customer or several customers, should be treated as a single contract if: a) The group of contracts is negotiated for a single package b) The contracts are closely related that they are in effect part of single project with an overall profit margin; c) The contracts are performed concurrently or in continuous sequence **Contract Revenue:** a) Initial amount contracted including retention b) Variation in contract works, claim, incentive payments To the extent probable that they will result in revenue They are capable of reliably measured Cost of Contract: Directly attributable costs Cost attributable to contract activity in general & can be allocated to contract Other cost specifically chargeable to customer as per agreement Allocated borrowing cost to the extent in accordance with ICDS-IX Note: Those Costs shall be reduced by any incidental income (other than not included in revenue) **Recognition of Contract revenue:** Contract Revenue shall be recognised on the basis of percentage completion method i.e.% completion= Cost incurred up to reporting date/ Total Estimated cost Current year revenue= Total revenue*POC – cost incurred up to reporting date **Note:** Early stage of contract shall not extend beyond %25 of the stage of completion **Determination of Completion of contract:** The portion of cost incurred on contract up to the reporting date Surveys of work performed Completion of physical portion of the contract **Disclosures:** The amount of contract revenue recognised The method used to determine the stage of completion Amount of cost incurred & recognised profit Amount of advance received Amount of retention	**Scope:** Applied in accounting of construction contract of contractor ⇒ A group of contracts whether with a single customer or several customers, should be treated as a single contract if: a) The group of contracts is negotiated for a single package b) The contracts are closely related that they are in effect part of single project with an overall profit margin; c) The contracts are performed concurrently or in continuous sequence **Contract revenue:** a) Initial amount contracted b) Variation in contract works, claim, incentive payments To the extent probable that they will result in revenue They are capable of reliably measured **Note:** AS 7 does not say anything about the inclusion of retention **Cost of Contract:** a) Directly attributable costs b) Cost attributable to contact activity in general & can be allocated to contract c) Other costs specifically chargeable to customer as per agreement d) Allocated borrowing cost to the extent in accordance with ICDS-IX **Recognition of Contract revenue:** Contract Revenue shall be recognised on the basis of percentage completion method i.e.% completion= Cost incurred up to reporting date/ Total Estimated cost Current year revenue= Total revenue*POC – cost incurred up to reporting date **According to AS-7:** Any estimated loss on contract shall be recognised immediately as an expense. If it is probable that total expense will exceed the revenue **Determination of Completion of contract:** The portion of cost incurred on contract up to the reporting date Surveys of work performed Completion of physical portion of the contract Disclosures: The amount of contract revenue recognised The method used to determine the stage of completion Amount of cost incurred & recognised profit Amount of advance received Amount of retention

ICDS-IV "Revenue recognition"	AS-9 "Revenue Recognition"
Scope: This ICDS deals with the basis for revenue recognition arising in ordinary course of activities of a person from a) The sale of goods b) Rendering of services c) The use by the other of person's resources yielding interest, Royalties or Dividends **Meaning of revenue:** Revenue is gross inflow of cash, receivables & other consideration arising in ordinary course of business from the sale of goods, rendering services, or form the use by the other person's resources yielding interest ,royalties& dividends **Note:** In agency relationship, commission is revenue not a gross inflow of cash & Receivable or other consideration **Sale of goods:** The revenue from the sales shall be recognised only when the control & Ownership incidental risk & rewards has been transferred with sale **Revenue shall be recognised if:** There is reasonable certainty of its collection If reasonable certainty of its collection cannot be determined recognition, shall be postponed. **Rendering of services:** All the requirements of ICDS-III "Construction Contracts" shall mutatis mutandis apply to service contract. Revenue under the service contract shall be completed on the basis of percentage completion method. The revenue under service contract with duration of not more than 90 days could be recognised when the service is completed or substantially completed. When the services provided by an indeterminate number acts over a specific period of time revenue may be recognised on the basis of straight-line method. **Interest:** Interest shall accrue on time basis determined by amount outstanding and the rate applicable. Interest on refund of any tax, duty or cess shall be deemed to be income of the previous year in which such interest is received as per Section 145A (b) of income-tax act 1961 Discount on debt securities held is treated as though it is accruing over the period to maturity	**Scope:** This AS deals with the basis for revenue recognition arising in ordinary course of activities of a person from a) The sale of goods b) Rendering of services c) The use by the other of person's resources yielding interest, Royalties or Dividends **Meaning of revenue:** Revenue is gross inflow of cash, receivables & other consideration arising in ordinary course of business from the sale of goods, rendering services, or from the use by the other person's resources yielding interest, royalties & dividends **Note:** In agency relationship, commission is revenue not a gross inflow of cash & Receivable or other consideration **Sale of goods:** The revenue from the sales shall be recognised only when the control & Ownership incidental risk & rewards has been transferred with sale **Revenue shall be recognised if:** There is reasonable certainty of its collection If reasonable certainty of its collection cannot be determined, recognition shall be postponed. **Rendering of Services:** The revenue under the service contract can be recorded on the basis of proportionate completion method or by the completed service contract method. **Interest:** Interest Accrues in most of the circumstances on the basis of time.

Royalties: Shall Accrue in accordance with the terms of relevant agreement & shall be recognised on that basis unless having regard to the substance of transaction ,it is more appropriate to recognise the revenue on some other systematic basis **Dividends:** Dividends are recognised with the provision of sec. 2(22) of income-tax act 1961 **Disclosures:** Following disclosures shall be made: a) In transaction of sale amount not recognised as revenue along with the nature of uncertainty b) Amount of revenue from service transactions recognised c) Method used to determine the stage of completion d) Service transaction in process at the end of previous year • Amount of cost incurred & recognised profits up to the end of previous year • The amount of advances received • The amount of retention	Determined by the amount outstanding and the rate applicable. Usually the premium & Discount on debt securities held is treated as though it is accruing over the period to maturity. **Royalties:** Shall Accrue in accordance with the terms of relevant agreement & shall be recognised on that basis unless having regard to the substance of transaction ,it is more appropriate to recognise the revenue on some other systematic basis **Dividends:** Dividends are not recognised in statements of profit & loss unless the right to receive the payments is established. **Disclosures:** Amount of revenue in course of sale transaction not recognised due to lack of certainty with nature of uncertainty.

ICDS-V "Tangible Fixed Assets"	**AS-10 "Property Plant & Equipment's"**
Scope: This ICDS deals with the treatment of tangible fixed Assets Tangible Fixed Assets: Is assets being Land ,Building ,machinery, plant & furniture Held for the use for the purpose of producing goods or providing services Not held for sale in ordinary course of business **Identification of Tangible Fixed Assets:** a) The definition of tangible fixed assets given above provides the criteria for determining whether an item is to classify a tangible fixed assets b) Standby Equipment's and servicing parts are to be capitalized machinery spares shall be charged to the revenue as when consumed. When spares can be used only in connection with the item of tangible fixed assets and their use is expected to be irregular, they shall be capitalize	**Scope:** This AS should be applied in accounting for Property, Plant& Equipments except when other AS requires or permits different Accounting treatments. This standard doES not apply to: a) Biological Assets related to agricultural activity other than bearer plants but it does not apply to the produce on bearer plants and b) Wasting assets including of mineral rights, Expenses on Exploration for and extraction of mineral oils, natural gas and similar non regenerative resources. However this standard apply to property, plant and equipment used to develop or maintain the assets described in (a) and (b) above **Property, plants and Equipment:** Are tangible assets • Held for use in the production process or supply of goods or services, for rental to others or for administrative purposes; and • Are expected to use for period of more than 12 months

Cost of Assets: It shall Comprise of	**Cost of Assets:**
a) Purchase price b) Import duties & other taxes (Excluding those subsequently recoverable) c) Directly attributable expenses making assets ready to use d) Any trade discount and rebate shall be deducted) Start-up & Commissioning costs shall be capitalized e) Expenses on test run before starting actual production shall be capitalized **Self-Constructed Assets:** In arriving the cost above principals shall be applied. Any Internal profits if any shall be ignored while arriving at the cost **Disclosures:** Following Disclosures shall be made in respect of tangible Fixed Assets a. Description of assets or block of assets. b. Rate of depreciation c. Actual cost or WDV as the case may be d. Addition deletion during the year or any adjustment made due to • Central Value Added tax credit claimed and Allowed under CENVAT Credit rules 2004 • Change in rate of exchange in currency • Subsidy or grant or reimbursement by what so ever name called	It shall comprise of a) Purchase price including import duties & Purchase taxes (Non-refundable) b) Any cost directly attributable to bring assets to the location and necessary condition to bring it to for it to operate c) Initial estimate of the cost of dismantling, removing the item and the restoring site on which it is located referred as decommissioning, Restoration and similar liabilities. **Self-Constructed Assets:** In arriving the cost above principals shall be applied. Any Internal profits if any shall be ignored while arriving at the cost **Disclosures:** An enterprise encouraged to disclose the following a. The carrying amount of temporarily held property, plant & equipment b. The gross carrying Amount of any fully depreciated property, plant and equipment's that is still in use c. For each revalued class of property plant and equipment's, the carrying amount that would have been recognised had the assets been carried under the cost model d. The carrying amount of property, Plant and equipment's Retired from active use and not held for disposal.

ICDS- VI "Effects of changes in foreign exchange"	**AS-11"Effects of changes in foreign exchange"**
Scope: This ICDS deals with: a. Treatment of transactions in foreign currencies b. Translating the financial statements of foreign operations c. Treatment of foreign currency transactions in nature of forward contracts. Foreign Operation: Foreign operation of person is branch by whatever name called of that person, the activities of which are based or conducted in country other than India. **Forward Exchange Contract:** Forward Exchange contract means an agreement to exchange different currencies at forward rate and includes a foreign currency option contract or another financial instrument of a similar nature. **Note:** Notwithstanding anything contained in AS11- initial recognition conversion and recognition of exchange difference shall be subject to provision of Section 43A of the ACT or the rule 115 of income-tax rules 1962. Section 43A deals with the provision of consequential to changes in rate of exchange of currency and rule 115 deals with rate of exchange for conversion into rupees of income expressed in foreign currency. **Translation of Foreign Operation:** financial statements of foreign operation shall be translated using the principles and procedures as if transactions of the foreign operation had been those of person himself. **Forward Exchange Contracts:** ICDS has Categorized the forward contracts in three types: a. For the trading or speculation purposes b. Hedge the foreign currency risk commitments of firm c. Other than these two categories. **Disclosures:** No disclosure required	**Scope:** This AS deals with: a. Treatment of transactions in foreign currencies b. Translating the financial statements of foreign operations Treatment of foreign currency transactions in nature of forward contracts. **Foreign Operation:** Foreign operation is subsidiary, associates, joint ventures or branch of reporting enterprise, The activity of which are based or conducted in country other than country of reporting enterprise. Forward exchange contract means an agreement to exchange different currencies at the forward rate. Translation of foreign Operation: Accumulate all the resulting exchange difference in foreign currency translation reserve until the disposal of net investments. **Forward Exchange Contracts:** No such categorization **Disclosure:** a. Amount of exchange difference included in profit & Loss b. Net accumulated difference in foreign translation reserve

ICDS-VII "Government Grants"	AS-12 "Government Grants"
Scope: This ICDS deals with the treatment of Government Grants. The government grants, are sometime called by names such as subsidies, cash incentive duty drawbacks, waiver, concessions, reimbursements, etc **Recognition in Book of Accounts:** Recognition of government grant shall not be postponed beyond the actual date of receipt .It means it shall be recognised on actual receipt basis even in case where there is not any reasonable assurance that the enterprise will not comprise with the condition attached to grants **Accounting treatment for Grants for Fixed Assets:** This ICDS says that where the government grant relates to depreciable fixed assets or the assets of a person, the grant shall be deducted from the cost of assets or the WDV of block of assets to which the concerned assets belongs, Thus this does not take into consideration the second method prescribed by AS-12 to Recognise as deferred revenue & Charge to The Profit & loss on systematic or rational basis. **Note: No any effect on tax treatment refer sec 43(1) of income-tax act 1961(Actual cost of Assets)-Explanation 10** **Treatment of grants not relatable to Assets Acquired:** This ICDS lays that if government grant is of such nature that it cannot be directly relatable with the assets acquired, so much amount which bears to the total government grant, the same proportion as such assets bears to all the assets in respect of or with reference to which the government grant is received, shall be deducted from the actual cost of assets or shall be reduced from the WDV of assets to class it belong (in line with explanation 43(1) explanation 10) **Residual Grants (other than above): This ICDS says that grants other than covered above shall be recognised as income over the periods necessary to match them to related cost which they are intended to compensate.** **Disclosure:** Following Disclosure is required in respect of Government grant, namely Nature & extent of government grants recognised during the previous year by way of deduction from the actual cost of assets or from the WDV of block of Assets during the previous year; Nature & extent of Government grants recognised during the previous year; Nature & Extent of government grants not recognised during the previous year by way of deduction from the actual cost of asset or assets or from the written down value of block of assets and reasons thereof; and income Nature and extent of government grants not recognised during the previous year as income and reason thereof.	**Scope:** 1. This AS deals with accounting for government grants. Government grants are sometime called by other names such as subsidies, cash incentive, Duty drawback etc. 2. This standard deals with the special problems arising in accounting for government grants in financial statements reflecting the effects of changing prices or in supplementary information of similar nature; **Recognition in Books of Accounts:** Government grants available to the enterprise shall be recognised in books only if: • Where there is reasonable assurance that the enterprise will comply with the condition attached to them and • Where such benefits have been earned by the enterprise and it is reasonably certain that the ultimate collection will be made. Note: Mere receipt of grant is not conclusive evidence that the condition attached will be fulfilled **Recognition in Book of Accounts:** There are two method of recognition Net assets Method Deferred Revenue Method **(**not Considered in ICDS) **Treatment of grants not relatable to Assets Acquired:** As per AS-12 "government grants" such grants are considered as promoter's contribution & transferred to capital Reserve. Such grants can neither be distributed as dividend nor considered as deferred income **Revenue Grants:** It is credited in profit & Loss statement & can be used to mitigate the loss incurred or to distribute dividend. There are no conditions regarding to use of grant otherwise specifically provided in terms of grants. **Disclosure:** Following Disclosure is required respect of Government grant, namely The accounting policy adopted for the government grants, including the method of presentation in financial statements; The nature and extent of government grants recognised in the financial statements, including grants of nonmonetary assets given at concessional rate or free of cost.

ICDS-VIII "Securities" **Scope: This ICDS deals with securities held as "Stock in trade"** It does not deal with The basis for recognition of interest & dividend on securities which are covered by ICDS on revenue recognition; Securities held by person engaged in the business of insurance Securities held by mutual funds, Venture capital fund, banks & Public Financial Institutions formed under the company's act 2013. **Note:** Meaning of securities shall be the meaning assigned to it in sec 2(h) of securities contract (regulation) act, 1956 and also include the shares of company in which public are not substantially interested. This standard deal with securities stock held as stock in trade, so it is of utmost importance to classify the security held as stock in trade & Investment **Recognition and valuation of Security:** There is a concept of two level valuation in ICDS • Initial Recognition: a. A security on acquisition shall be recognised at actual cost b. The cost of security shall be comprised of acquisition charges such as STT paid, brokerage & fees etc. c. Where Security is acquired in exchange for another assets fair value of security so acquired shall be cost d. Where unpaid interest has accrued before acquisition & charged in Purchase price when such interest realized shall be distributed in pre & post acquisition & Pre acquisition shall be adjusted with Cost price. **Subsequent Recognition:** • At the end of the previous year's securities held as stock in trade shall be valued at cost initially recognised or net realizable value at the end of that previous year, whichever is lower (In line with ICDS-II) • For the purpose of preceding para, the Comparison of actual cost initially recognised and the net realizable value shall be done category wise and not for each individual security. For this purpose security shall be classified into following category wise namely:	Note: No corresponding Accounting Standard. However, for securities held as investment, AS- 13 Accounting of investment is applicable

a. Shares b. Debt securities c. Convertible Securities and d. Any other securities not covered above. **Note:** Where the actual cost initially recognised cannot be ascertained by reference to specific identification ,the cost of such security shall be determined on the basis of first-in-first out method or weighted Average method. **Disclosure:** No disclosure required in point no, 13 (f) of form 3CD.	

ICDS-IX "Borrowing costs"	**AS-16 "Borrowing Cost"**
Scope: This ICDS deals with treatment of borrowing costs. This income computation & Disclosure doesn't deal with actual or imputed cost of owners' equity and preference capital. **Meaning of borrowing cost:** Commitment charges on borrowing; Amortized amount of discounts or premiums relating to borrowings; Amortized amount of ancillary costs incurred in connection with the arrangement borrowings. Finance charges in respect assets acquired under the finance leases or under other similar arrangements. **Qualifying Assets:** Mean Land, building, machinery, plant or furniture being tangible assets; Knowhow, patents, copyrights, Trademarks, or any other business or commercial rights being intangible assets Inventories that require 12 months or more to bring them in saleable condition. **Capitalization of Specific borrowing costs:** Borrowing cost specifically incurred in acquisition, construction and Production of a qualifying asset shall be capitalized as part of the cost of those assets. The amount borrowing costs eligible for capitalization shall be the amount computed under this ICDS other borrowing costs shall be recognised in accordance with the provision of the Act. ICDS do not allow to deduct such income. But to credit in Profit & Loss Account **Capitalisation of general Borrowing costs:** This ICDS has provided the formula for finding the capitalization amount.	**Scope:** This AS deals with treatment of borrowing costs. This income computation & Disclosure doesn't deal with actual or imputed cost of owners' equity and preference capital. **Meaning of borrowing cost:** Commitment charges on borrowing; Amortized amount of discounts or premiums relating to borrowings; Amortized amount of ancillary costs incurred in connection with the arrangement borrowings. Finance charges in respect assets acquired under the finance leases or under other similar arrangements. Exchange difference arising in foreign exchange borrowing to the extent regarded as adjustment of interest.(Not considered in ICDS) **Qualifying Assets:** Mean Qualifying assets is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale. Further it explains the what constitute substantial period depends upon circumstances of each case **Capitalization of Specific borrowing costs:** The capitalization of borrowing costs as part of the cost of a qualifying asset should commence when all the following conditions are satisfied: Expenditure for the acquisition, construction or production of a qualifying asset is being incurred; Borrowing costs are being incurred; and Activities that are necessary to prepare the asset for its intended use or sale are in progress. Income on temporary investments of borrowing Amount: Deduct any income from the short term investment of borrowing also form the borrowing cost.

Borrowing cost=A*B/C Where A= amount of borrowing cost aggregate B= Amount incurred in respect of Qualifying Assets C= Total Amount of borrowing **Commencement of Capitalization:** The capitalization of borrowing costs shall commence: In case of specific borrowing the date on which funds were borrowed; In case of general borrowing the date when funds were Utilised **Suspension of capitalization:** No such provision in ICDS-IX **Cessation of Capitalization:** Capitalization of borrowing cost ceases if: • In case of qualifying assets (other than inventory) when such assets first put to use • In case of inventory when substantially all the activities necessary to prepare such inventory of its intended use or sale. **Note:** when the construction completes in parts and a completed part is capable of being used while the construction continue for the other parts, Capitalization ceases in respect of such completed part. **Disclosure:** The following disclosure shall be made in respect of borrowing costs namely: • The accounting policy adopted for the borrowing costs; and • The amount of borrowing costs capitalized during the previous year.	**Capitalisation of general Borrowing costs:** To the extent that funds borrowed generally and used for the purpose of obtaining a qualifying assets, the amount of borrowing cost eligible for capitalization should be determined by applying a capitalization rate to the expenditure on that assets. The capitalization rate should be the weighted average of the borrowing costs applicable to the borrowings of the enterprise that, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalized during a period should not exceed the amount of borrowing costs incurred during that period Commencement of Capitalization: The capitalization shall. **commence:** Expenditure for the acquisition, construction or production of qualifying assets is being incurred; Borrowing costs are being incurred Activities that are necessary to prepare the assets for its intended use or sale are in progress. **Suspension of capitalization:** Capitalization of borrowing cost shall be suspended during the extended period in which active development is interrupted **Disclosure:** The following disclosure shall be made in respect of borrowing costs namely: • The accounting policy adopted for the borrowing costs; and • The amount of borrowing costs capitalized during the previous year

ICDS-X "Provisions, Contingent liabilities and Contingent Assets" **Scope:** This ICDS deals with provisions, contingent Assets, contingent liabilities except those: a. Resulting from financial instruments; b. Resulting from executory contracts; c. Arising in insurance business from the contracts with policy holders d. Covered by any other ICDS **Recognition of Provision: A provision should be recognised when:** When a person has present obligation a result of a past event; It is reasonably certain that outflow of resources embodying economic benefits will be required to settle such obligation A reliable estimate can be made of amount of obligation If these conditions are not met, no provision shall be recognised	**AS-29 "Provisions, Contingent liabilities and Contingent Assets"** **Scope:** same as ICDS **Recognition of Provision**: A provision should be recognised when: An enterprise has present obligation as result of past event It is probable (means more likely than not) that an outflow of resources embodying economic benefits will be required to settle such obligation A reliable estimate can be made of amount of the obligation If these conditions are not met no provisions should be recognised **Disclosures:** Following disclosures shall be required to be made The carrying amount at the beginning and end of the period The additional provision made in the period including increase to existing provision Amount used Unused amounts reversed during the period.

Disclosures: Following disclosures shall be made in respect of each class of provisions, namely As brief description of the nature of obligation The carrying amount at the beginning and end of the previous year; Additional provisions made during the previous year, including increase to existing provisions Amount used that is incurred and charged against the provisions during the previous year Unused amounts reversed during the previous year and The amount of expected reimbursement stating that amount of any assets that has been recognised for that expected reimbursement.	

6. APPLICABILITY OF IND AS

As per Section 133 of the Companies Act, 2013 Ind AS shall be applicable to Companies registered under Companies Act, 2013 as follows:

Ind AS were notified on 16 February 2015 by the Ministry of Corporate Affairs ("MCA"). MCA notified the Companies (Indian Accounting Standards) Rules, 2015 which specify the Ind AS applicable to certain class of Companies and set out the dates of applicability.

6.1 Voluntary adoption

Companies may voluntarily adopt Ind AS for financial statements for accounting periods beginning on or after 1 April 2015, with the comparatives for the periods ending 31 March 2015 or thereafter. Once a company opts to follow the Ind AS, it will be required to follow the same for all the subsequent financial statements.

6.2 Mandatory adoption

For the accounting periods beginning on or after 1 April 2016	**For the accounting periods beginning on or after 1 April 2017**
Companies whose equity and/ or debt securities are listed or are in the process of listing on any stock exchange in India or outside India (listed companies) and having net worth of Rs. 500 crores or more. Unlisted companies having a net worth of Rs. 500 crores or more. - Holding, subsidiary, joint venture or associate companies of the listed and unlisted companies covered above.	Companies whose equity and/ or debt securities are listed or are in the process of listing on any stock exchange in India or outside India (listed companies) and having net worth of Rs. 500 crores or more. Unlisted companies having a net worth of Rs. 500 crores or more. - Holding, subsidiary, joint venture or associate companies of the listed and unlisted companies covered above.

6.3 The roadmap will not be applicable to

- Companies whose securities are listed or in the process of listing on SME exchanges.
- Companies not covered by the roadmap in the "Mandatory adoption" categories above.
- Insurance companies, banking companies and non-banking finance companies.

These companies should continue to apply existing Accounting Standards prescribed in the Annexure to the Companies (Accounting Standards) Rules, 2006, unless they opt for voluntary adoption. Insurance companies, banking companies and non-banking finance companies cannot voluntarily adopt the Ind AS.

7. LIST OF ICDS AND COMPARABLE IND AS ISSUED BY MCA

Sl. No.	ICDS	Comparable Ind AS
1.	Accounting policies (ICDS I)	Presentation of financial statements (Ind AS 1)
2.	Valuation of inventories (ICDS II)	Inventories (Ind AS 2)
3.	Construction contracts (ICDS III)	Revenue from contracts with customers (Ind AS 115)
4.	Revenue recognition (ICDS IV)	Revenue from contracts with customers (Ind AS 115)
5.	Tangible fixed assets (ICDS V)	Property, plant and equipment (Ind AS 16)
6.	Effects of changes in foreign exchange rates (ICDS VI)	The effects of changes in foreign exchange rates (Ind AS 21)
7.	Government grants (ICDS VII)	Accounting for government grants and disclosure of government assistance (Ind AS 20)
8.	Securities (ICDS VIII)	Financial instruments (Ind AS 109)
9.	Borrowing costs (ICDS IX)	Borrowing costs (Ind AS 23)
10.	Provisions, contingent liabilities and contingent assets (ICDS X)	Provisions, contingent liabilities and contingent assets (Ind AS 37)

8. COMPARISON BETWEEN ICDS AND IND AS

ICDS –I "Accounting Policies"	**Ind AS – 1"Presentation of financial statements"** ***It is similar to AS-1*** except with applicability prospective application. As per the Ind AS, application should be retrospective by adjusting the opening equity and comparatives unless impracticable.
ICDS–II "Valuation of Inventories" There is no specific provision in relation to reversal of write-down of inventory	**Ind AS–2"Inventories"** Similar to AS except that difference between the purchase price for normal credit terms and the amount paid, is recognised as interest expense over the period of the financing. Reversal of write-down of inventory is permitted. The amount of reversal is limited to the original write down.

ICDS-III "Construction Contracts"	**Ind AS–115 "Revenue from contracts with customers"** Applies to contract with a customer and establishes principles on reporting the nature, amount, timing and uncertainty of revenue and cash flows arising from a contract with customer. • A contract is an agreement between two or more parties that creates enforceable rights and obligations, and can be either written, oral or implied by an entity's customary business practices. • Revenue is defined as income arising in the course of an entity's ordinary activities.

	• Income is defined as increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in an increase in equity, other than those relating to contributions from equity participants. • The core principle under Ind AS 115 is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. • To achieve that core principle, the following steps are applied:

	a. Identify the contract(s) with a customer. b. Identify the performance obligations in the contract (account for a 'distinct' good or service). c. Determine the transaction price. d. Allocate the transaction price to the performance obligations in the contract. e. Recognise revenue when (or as) the entity satisfies a performance obligation. A contract falls within the scope of Ind AS 115, when all the following conditions are met: a. The contract has commercial substance (that is, the risk, timing, or amount of future cash flows is expected to change as a result of the contract) b. The parties to the contract have approved the contract c. Each party's rights regarding the goods or services to be transferred can be identified d. Payment terms can be identified for the goods or services to be transferred e. The parties are committed to perform their respective obligations and they intend to enforce their respective contractual rights f. It is probable that the entity will collect the consideration to which it expects to be entitled. Guidance provided as part of the standard for combining the contract entered into, at or around the same time with the same customer (negotiated as a package, consideration to be paid in one contract depends on the price and performance of the other contract, the goods or services promised in the contracts are a single performance obligation).

	Contract modification is treated as a separate contract if the modification results in 8. Addition of 'distinct goods or services' and 9. A change in consideration that reflects the entity's stand-alone selling price for such additional promised goods or services. If modification does not meet the criteria to be accounted for as a separate contract, determination needs to be made on whether to account for modification as a. Termination of the original contract and creation of a new contract (i.e. allocate the amount of consideration not yet recognised to the remaining performance obligation) or b. As if it were part of the original contract (i.e. update the transaction price, measure progress toward complete satisfaction of the performance obligation, and record a cumulative catch-up adjustment to revenue). Accordingly, change orders and claims (price adjustments, or changes in scope) need to be assessed if a. The customer has approved any change in scope or price, or b. it has enforceable rights to considerations, and accordingly apply contract modification guidance • A contract does not exist if the contract provides for a unilateral enforceable right to terminate a wholly unperformed contract without compensating the other party (or parties). • Any considerations received on such arrangements from the customer are recorded as a liability and recognised as revenue only when there is no remaining obligation to the customer and the amount is not refundable or the contract has been terminated and the consideration received from the customer is non-refundable.
ICDS–IV "Revenue Recognition"	**Ind AS–115 "Revenue from contracts with customers"** Unlike ICDS and AS, Entity recognises revenue when (or as) it satisfies a performance obligation by transferring control of a good or service to a customer. Control may be transferred either at a point in time or over time. Entity that recognises revenue over time should select the method that depicts the performance. This may be either an output method (example: units produced) or an input method (example: costs incurred or labour hours). Ind AS 115 requires evaluation of performance obligations – to account for 'distinct' goods or services (or a bundle of distinct goods or services, or a series of distinct goods or services – i.e. a separate unit of account) based on the following criteria:

	a. The customer can benefit from the goods or services either on its own or together with other resources that are readily available to the customer, b. Promise to transfer the good or services to the customer is separately identifiable from other promises in the contract (that is, the goods or services is distinct within the context of the contract). ● A good or service that does not meet these criteria would be combined with other goods or services in the contract until the criteria are met. ● Variable considerations (including potentially contingent considerations) are only included in the transaction price to the extent that it is probable that the amount of cumulative revenue recognised would not be subject to a significant future revenue reversal when such estimates are revised. ● Penalties should be accounted for as per the substance of the contract. Where the penalty is inherent in the determination of transaction price, it should form part of variable consideration, otherwise the same should not be considered for determining the consideration and the transaction price should be considered as fixed. ● Revenue is recognised as 'control' of the goods or services underlying the performance obligation are transferred to the customer. ● Ind AS 109 applies to dividend income recognised in profit or loss. Dividends are recognised in profit or loss only when: a. The entity's right to receive payment of the dividend is established; b. it is probable that the economic benefits associated with the dividend will flow to the entity; and c. The amount of the dividend can be measured reliably
ICDS–V "Tangible Fixed Assets"	**Ind AS–16"Property, plant and equipment"** *Similar to AS except for the following:* Spare parts, stand-by equipment and servicing equipment should be capitalised only when they meet definition of Property, Plant and Equipment (PPE). Costs incurred on an item of PPE, when an item is capable of operating in the manner intended by management but is not yet brought into use or is operating at less than full capacity, should not be included in the carrying amount of such item. Difference between the purchase price under normal credit terms and the amount paid, is recognised as interest expense over the period of the financing. The cost of an item of PPE includes such costs Depreciation is based on the 'component' approach; depreciation is charged over the estimated useful life of the asset.

ICDS–VI "The effects of changes in foreign exchange rates"	**Ind–AS 21 "The effects of changes in foreign exchange rates"** *Similar to AS except for the following:* Functional currency is defined as the currency of the primary economic environment in which an entity operates. Entities should give priority to number of primary indicators before considering secondary indicators when the indicators are mixed and the functional currency is not obvious. Derivatives are measured at fair value with change in fair value recognised in profit or loss unless they qualify as hedging instruments in a cash flow hedge or in a net investment hedge.
ICDS–VII"Government grants"	**Ind AS – 20 "Accounting for government grants and disclosure of government assistance"** *Similar to AS except for the following:* Government grants related to assets shall be presented in the Balance Sheet by setting up the grant as deferred income, which is recognised in profit or loss on a systematic basis over the useful life of the asset. Recognition of grants in capital reserve is not permitted. Government loans with below market rate of interest are initially recognised at fair value in accordance with Ind AS 109 and the difference between proceeds received and the initial fair value is accounted as government grant. Refund of a grant related to an asset shall be recognised by reducing the deferred income balance by the amount refundable.
ICDS–VIII Securities	**Ind AS–109 "Financial instruments"** *Similar to AS except for the following:* Actual costs comprises of purchase price and acquisition charges such as brokerage, fees, tax, duty or cess. Securities are recorded at their fair value on the date of acquisition. Transaction costs that are directly attributable to the acquisition of financial assets are included in amount recognised on initial recognition, in case of financial asset not designated at fair value through profit or loss. Depending upon the entity's business model for managing the financial assets and the contractual cash flow characteristics of the securities, securities are measured at a. amortised cost; or b. fair value through other comprehensive income; or c. fair value through profit or loss. d. Measured on standalone basis. Further, if certain conditions are met, an entity can measure the group of assets with offsetting risk positions on the basis of its net exposure instead of individual positions within the group (portfolio measurement exception).
ICDS–XI Borrowing Costs	**Ind AS–23** "Borrowing costs" Similar to AS
ICDS–X Provisions, contingent liabilities and contingent assets	**Ind AS–37 "Provisions, contingent liabilities and contingent assets"** Similar to ICDS and AS. However, where the effect of the time value of money is material, the provision shall be discounted at a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the liability.

9. AMENDMENTS IN RELATION TO NOTIFIED INCOME COMPUTATION AND DISCLOSURE STANDARDS

In order to bring certainty in the wake of recent judicial pronouncements on the issue of applicability of ICDS, the following amendments have been made vide Finance Act, 2018 with retrospective effect from 1st April, 2017:

i. Section 36 of the Act has been amended to provide that marked to market loss or other expected loss as computed in the manner provided in ICDS notified under sub-Section (2) of Section 145, shall be allowed as deduction.

ii. Section 40A of the Act has been amended to provide that no deduction or allowance in respect of marked to market loss or other expected loss shall be allowed except as allowable under newly inserted Clause (xviii) of sub-Section(1) of Section 36.

iii. A new Section 43AA in the Act has been inserted to provide that, subject to the provisions of Section 43A, any gain or loss arising on account of effects of changes in foreign exchange rates in respect of specified foreign currency transactions shall be treated as income or loss, which shall be computed in the manner provided in ICDS as notified under sub-Section (2) of Section 145.

iv. A new Section 43CB has been inserted to provide that profits arising from a construction contract or a contract for providing services shall be determined on the basis of percentage of completion method except for certain service contracts, and that the contract revenue shall include retention money, and contract cost shall not be reduced by incidental interest, dividend and capital gains.

v. Section 145A of the Act has been amended to provide that, for the purpose of determining the income chargeable under the head "Profits and gains of business or profession,—

a. The valuation of inventory shall be made at lower of actual cost or net realizable value computed in the manner provided in ICDS notified under (2) of Section 145.

b. The valuation of purchase and sale of goods or services and of inventory shall be adjusted to include the amount of any tax, duty, cess or fee actually paid or incurred by the assessee to bring the goods or services to the place of its location and condition as on the date of valuation.

c. Inventory being securities not listed, or listed but not quoted, on a recognised stock exchange, shall be valued at actual cost initially recognised in the manner provided in ICDS notified under (2) of Section 145.

d. Inventory being listed securities, shall be valued at lower of actual cost or net realisable value in the manner provided in income computation and disclosure standards notified under (2) of Section 145 and for this purpose the comparison of actual cost and net realisable value shall be done category-wise.

e. A new Section 145B has been inserted in the Act to provide that interest received by an assessee on compensation or on enhanced compensation, shall be deemed to be the income of the year in which it is received.

f. The claim for escalation of price in a contract or export incentives shall be deemed to be the income of the previous year in which reasonable certainty of its realisation is achieved.

g. Income referred to in sub-Clause (xviii) of Clause 24) of Section 2 shall be deemed to be the income of the previous year in which it is received, if not charged to income-tax for any earlier previous year.

10. The AO is bound to give effect to provisions of Section 145(1) r.w.s. 145(2) where ICDS notified by Central Government from time to time are not complied with. Such accounts will have to be rejected and best judgment, assessment will have to be made *u*/s 145(3) read with Section 144. An AO has to take note of all deviations from the ICDS, reasons for such deviations and their implications in taxable income. In case of gross deviation, the AO will, depending upon the significance of the item in computation of total income, have to consider whether the accounts require to be rejected.

CHAPTER

12

Director's/ Auditor's Reports

1. The Financial statements normally submitted are:

1. Annual statements of accounts, namely, Trading/ Manufacturing account, Profit & Loss a/c, and balance-sheet.
2. Capital account of proprietor/ partners.
3. Tax Audit Reports in cases where Section 44AB of the Act is attracted.
4. Auditor's report and Director's report prescribed under Companies Act, in respect of Limited Companies.
5. Special audit reports applicable to special class of assessees, eg. Trusts, Exporters, etc.

2. LIMITATIONS OF FINANCIAL STATEMENTS

2.1 These statements contain information which is historical in nature and are based on certain accounting concepts, standards and conventions. Therefore, they may, or may not reveal the information that a tax investigator needs. At times, taxpayers resort to manipulation of data, or "window dressing", for tax or financial purposes. Some of the approaches adopted in this regard are:

***Changes in Accounting Policies in respect of:**

- method of charging depreciation on fixed assets;
- valuation of inventory, investments and fixed assets;
- treatment of liability towards gratuity payable to the employees;
- treatment of contingent liabilities.

***Revaluation of Fixed Assets of the Firm:** Though all the cases of revaluation may not be for ulterior reasons, yet a firm with weak financial position, due to continuous losses, may revalue its fixed assets upwards, with an intention of showing better financial position. The converse of this can also be resorted to, for lowering tax liabilities.

***Capitalisation of interest on term loans and deferred payment liabilities.**

***Provision of higher depreciation, etc.**

Therefore, these statements need close scrutiny, to see whether any of the above manipulations have taken place. The auditor's report and notes to the balance-sheet may give vital clues in this regard. Analysis of financial statements may have to be again undertaken, after the areas of manipulation have been identified.

3. DIRECTOR'S REPORT

3.1 The Board of Directors is an important body elected by the shareholders, which acts as an agent of shareholders. The Board is collectively responsible for making policies for good governance and efficient running of the company. The Companies Act, 2013 has enhanced the accountability and responsibilities of directors by clearly defining their duties and responsibilities, qualification of independent directors and mandating certain disclosures, such as evaluation of performance of Board, CSR policy, whistle blower mechanism, risk policies etc in the Directors report.

3.2 Director's report together with complete financial statements and auditors report are sent along with notice of Annual General Meeting (AGM) to members of the company. As per Section 134 of the Companies Act, 2013, it is applicable for financial year commencing on or after 01 April 2014. The Director's report shall be prepared based on the *"stand alone financial statements of the Company"*. These reports as a bunch are popularly known as Annual Reports and are considered to be one of the best means used for apprising the shareholders about the performance of the company, market scenario, its subsidiaries. Director's report also reflects the standard of corporate governance and efficiency of directors in conducting the business.

4. CONTENTS OF DIRECTOR'S REPORT

4.1 Section 134(3) states that Board's report shall be attached to financial statements laid before the shareholders for adoption. It also mandates that such Board's report shall disclose or deal with the following:

a. The extract of the annual return as provided under sub-Section (3) of Section 92

(New requirement).

b. Number of meetings of the Board.

c. Directors' Responsibility Statement.

d. A statement on declaration given by independent directors under sub-Section (6) of Section 149.(New requirement)

e. Listed companies and such class of companies as may be prescribed Section (Section178(1)) must disclose company's policy on directors' appointment and remuneration including criteria for determining qualifications, positive attributes, independence of a director and other matters provided under Section 178(3)

f. Explanations or comments by the Board on every qualification, reservation or adverse remark or disclaimer made by the statutory auditor in his report; and by the company secretary in practice in his Secretarial audit report {Section 204(3)} (New requirement)

g. Particulars of loans, guarantees or investments under Section 186 (New requirement).

h. Particulars of contracts or arrangements with related parties referred to in sub-Section (1) of Section 188 in the prescribed form. The prescribed Rule states that such related party transactions must be reported in the prescribed Form No. 9.5 (New requirement).

i. The state of the company's affairs.

j. The amounts, if any, which it proposes to carry to any reserves.

k. The amount, if any, which it recommends should be paid by way of dividend.

l. Material changes and commitments, if any, affecting the financial position of the company which have occurred between the end of the financial year of the company to which the financial statements relate and the date of the report.

m. The conservation of energy, technology absorption, foreign exchange earnings and outgo. Rules 9.10 (3) specifies the manner in which these are to be reported.

n. A statement indicating development and implementation of a risk management policy for the company including identification therein of elements of risk, if any, which in the opinion of the Board may threaten the existence of the Company. (New requirement)

o. The details about the policy developed and implemented by the company on corporate social responsibility initiatives taken during the year.(New requirement)

p. In case of a listed company and every other public company having paid-up share capital of 25 crores or more, a statement indicating the manner in which formal annual evaluation has been made by the Board of its own performance and that of its committees and individual directors (Rule No. 9.10(4). (New requirement)

q. Such other matters as may be prescribed. The Rule No. 9.10(5) gives an indication of these matters.

- financial summary/ highlights; change in the nature of business, if any,
- Details of directors or key managerial personnel who were appointed or have resigned during the year. (New requirement) Names of companies which have become or ceased to be its Subsidiaries, joint ventures or associate companies during the year along with reasons thereof. Details relating to Deposits covered under Chapter V of the Act namely a) Accepted during the year (b) remained unpaid or unclaimed as at the end of the year(c) whether there has been any default in repayment of deposits or payment of interest thereon during the year and if so, number of such cases and the total amount involved, orders passed by Regulators or Courts or Tribunal, which impact the company's operations in future.

4.2 Directors Responsibility Statement (DRS): It is necessary to make a specific mention about significance of this statement. DRS basically gives assurance to the shareholders of the company. However, it thrusts huge responsibility on the Board not only to frame correct policies, internal financial controls but also to ensure their proper implementation. The Directors have to confirm the following:

a. Applicable accounting standards have been followed with explanation for any material departures.

b. Selected accounting policies have been applied consistently to give a true and fair view of the state of affairs of the company at the end of the financial year and of the profit and loss of the company for that period.

c. Proper and sufficient care has been taken for the maintenance of adequate accounting records for safeguarding the assets of the company and for preventing and detecting fraud and other irregularities.

d. The Annual Accounts are prepared on a going concern basis.

e. In the case of a listed company, internal financial controls laid have been followed by the company and that such controls are adequate and are operating effectively. The Explanation clarifies that such controls means policies and procedures adopted and adherence by the company for orderly and efficient conduct of the business for safeguarding assets, prevention and detection of frauds and errors and maintenance of accounting records and timely preparation of financial statements and review its efficacy.(New requirement)

f. The directors had devised proper systems to ensure compliance with the provisions of all applicable laws and that such systems were adequate and operating effectively. (New requirement)

4.3 Other Disclosures/ Requirements: In case of revision or re-opening of financial statements or Board report, detailed reasons must be stated in the director's report for such revision of statements or directors report{Section 131(1)-Third Proviso}. Board's report shall disclose the composition of audit committee and reasons for not accepting recommendations of audit committee, if any {Section 177(8)}. Report on establishment of vigil mechanism{Section 177(10)} & Secretarial audit report in prescribed form shall be annexed to Board's report as per Section 204.

4.3.1 As a good practice certain disclosures have been appearing as common in all directors' reports. Some of these are:

1. Directors liable to retire
2. Appointment or cessation of directors
3. Reappointment of auditors and remuneration.

4.4 Authentication of Board's Report: The Board's report and annexures forming part of it shall be signed by the Chairperson of the company, if he is authorised by the Board. But if the Chairperson is not authorized, it shall be signed by at least two directors, one of whom shall be a Managing Director.

5. AUDITOR'S REPORT

A tax audit, is to be compulsorily performed by a practising full time CA and as per rule 6G, he has to report the same in Form 3CA/ 3CB and 3CD. These reports are not to be given, when the audit *u*/s 44AB is not performed and in case of presumptive taxation Sections. If the assessee wants to avail any deduction *u*/s 80-IA, 80-IB etc.., the auditor needs to give additional audit reports. The contents of the various Audit Reports, the forms used and how to interpret them are discussed below.

5.1 Form 3CA: It is used when the assessee is required to be audited under the provisions of other Acts/ legislations. A brief of the contents of this form is as follows:

- he first Para of the report refers to the fact that the statutory audit was conducted by a CA or auditor as defined, in the Companies Act. If the audit was conducted by some other person other than the tax auditor his name is required to be mentioned.
- The second Para talks about the opinion of the tax auditor.
- The third Para discusses about the reasons for negative opinion if any, expressed.
- The fourth paragraph talks about the branch auditors (if audited by any other person).
- The report ends with the seal and signature of the person who conducts the audit, his membership no., place and date along with seal. These days Firm Registration number is also mandatory.

5.2 Form 3CB: It is used when the person is required to get himself audited due to the applicable turnover limits of Section 44AB of the I.T. Act 1961. Form 3CD is issued only for the year ending 31st March. If an assessee doesn't follow this type of year end then the auditor has to make specific changes in financial statements to bring them in line with these provisions. He has to certify that the financial statements are in agreement to the books of accounts maintained at various offices and branches. The salient points of this report are as follows:

- That the Balance Sheet and Profit and Loss account were in agreement with the books, the books are properly maintained and according to the information and explanation given to the auditor the particulars in Form 3CD give a true and correct view.
- The auditor may have various differences of opinion with regards to auditee's financial statements. These differences are to be pointed out individually under various heads of 3CD report. This form contains 32 Clauses and the auditor has to report extensively on various points. It needs to be annexed with the either Form 3CA or 3CB, whichever is appropriate. The various official pronouncement's, case laws, SA, AS and AS (IT) are also required to be considered in the Report. The information in form 3CD shall be based purely on the books of accounts, records, information and explanation made available to the auditor for his examination.
- In the case of a firm or Association of Persons the names of the partners/ members and their profit sharing ratios, any change in the partners or members or in their profit sharing ratio since the last date of the preceding year.
- The nature of business or profession, books of account maintained & examined {*The Auditor needs to check the compliance with Rule 6F here, in case he has given Form 3CB and if he is given Form 3CA, the compliance from the relevant statues for the books has to be checked.*}
- Whether the profit and loss account includes any profits and gains assessable on presumptive basis?
- Method of accounting employed and whether there has been any change in the method of accounting employed *vis-á-vis* the method employed in the immediately preceding previous year. If yes, then details of such change and the effect thereof on the profit or loss.
- Details of deviation, if any, in the method of accounting employed in the previous year from the Accounting Standards/

ICDS prescribed under Section 145 and the effect thereof on the profit or loss. The details of deviation observed after adopting the new method of accounting shall be disclosed, if it is contradictory to the methods as prescribed by Section–145. If the deviation is not ascertained, its impact on current and future profits needs to be reported here. {*The Auditor needs to take a written confirmation from the client about the method of accounting followed as per ICDS-1. Apart from this, he also has to check for the compliance with respect to AS (IT)-1*}

- Method of valuation of closing stock employed in the previous year for each class of inventory over here i.e. raw materials, WIP, Finished goods, Stock and spares, etc., details of deviation, if any, from the method of valuation prescribed under Section 145A, and the effect thereof on the profit or loss. Any deviations found, when compared to Section 145 against the change in method of valuing the stock shall be reported. Its impact on profit also needs to be disclosed. {*The Auditor needs to study the procedure of valuing the stock which needs to be followed every year consistently along with the basis adopted in valuing it. In accordance to Section 145A, he needs to verify that all taxes applicable have been added to cost valuation or not.*}
- **Particulars of the Capital Asset Converted into Stock-in-trade:** the description of the asset, its date of acquisition (to know whether it is long term or short term), the cost of acquisition (the historical cost/ purchase cost) and the conversion amount needs to be disclosed separately. {*The Auditor needs to check out the nature of asset, its reason for conversion and the method of conversion used. The implication of capital gains are not considered in reporting here*}
- **Amounts not Credited to the Profit and Loss Account,** Being the items falling within the scope of Section 28, the performa credits, drawbacks, refund of duty of customs or excise or service tax, or refund of sales tax or value added tax, where such credits, drawbacks or refunds are admitted as due by the authorities concerned, escalation claims accepted during the previous year, any claims not credited to profit and loss account, any other item of income & capital receipt, if any. This is one of the most vulnerable area where a client can push away the claim received in the next year and understate his profit. If doubtful, Auditor should obtain a cross confirmation letter.
- **Particulars of Depreciation Allowable as per the Income-tax Act, 1961** in respect of each asset or block of assets, with description of asset/ block of assets, rate of depreciation, actual cost or written down value, additions/ deductions during the year with dates; in the case of any addition of an asset, date put to use; depreciation allowable and WDV at the end of the year. The cost of asset derived and the treatment for the special transactions like the subsidy received, foreign currency translation gain losses and the tax paid are to be shown. {*The Auditor is bound to check the asset classification, its block wise classification, the WDV worked out at the end and the rate of depreciation applicable. The arrival of the cost of asset needs to be checked. Most important item is the use of CENVAT credit. As per the guidance note on CENVAT Credit Rules, the inclusive method is to be followed and a credit of 50% is allowed.*}

- **Amounts Admissible Under Sections 33AB, 33ABA, 33AC, 35, 35ABB, 35AC, 35CCA, 35CCB, 35D, 35DD, 35DDA, 35E** debited to the P&L account (showing the amount debited and deduction allowable under each Section separately) and also not debited to the profit and loss account.
- The sum paid to an employee as bonus or commission for services rendered, where such sum was otherwise payable to him as profits or dividend. [Section 36(1) (ii)], the sum received from employees towards contributions to any provident fund or superannuation fund or any other fund mentioned in Section 2(24) (x) with due date for payment and the actual date of payment to the concerned authorities under Section 36(1) (va). {*An auditor has to scrutinise all the ledger of employees and their contribution towards various funds/ schemes. He has to check the payment challans for the timely deposits and go through the returns. For any additions of employees made during the year, their agreement and the communication made to respective departments need to be checked.*}
- **Amounts Debited to the Profit and Loss Account**, being expenditure of capital nature, expenditure of personal nature, expenditure on advertisement in any souvenir, brochure, tract, pamphlet or the like, published by a political party, expenditure incurred at clubs as entrance fees and subscriptions and as cost for club services and facilities used.
- Expenditure by way of penalty or fine for violation of any law for the time being in force, any other penalty or fine, expenditure incurred for any purpose which is an offence or which is prohibited by law: Thus, all the penalties and fines have to be reported but the auditor has to state just the facts and not to check about its disallow ability. It covers only penalty and fines and not interest on late payments, penalty on breach of contracts, foreclosure of any term loans etc. The tax auditor should obtain a written confirmation for the client for the type of penalty, its nature and effect, the payment mode and the procedure for recording the same in books of accounts.
- Amounts inadmissible under Section 40(a), interest, salary, bonus, commission or remuneration inadmissible under Section 40(b)/ 40(ba) and computation thereof. All the amounts in excess of the limits specified, paid to partners or members has to be reported here.
- Amount inadmissible under Section 40A(3), read with rule 6DD [with break-up of inadmissible amounts], Provision for payment of gratuity not allowable under Section 40A(7), any sum paid by the assesse as an employer not allowable under Section 40A(9).
- Particulars of any liability of a contingent nature: The Auditor has to check for the contingencies report at the beginning of the year and evaluate its status.
- Amount of deduction inadmissible in terms of Section 14A in respect of the expenditure incurred in relation to income, which does not form part of the total income.
- Amount inadmissible under the proviso to Section 36(1)(iii), amount of interest inadmissible under Section 23 of the Micro Small and Medium Enterprises Development Act, 2006 {*The tax auditor*

has a varied amount of duties to be performed here too. (i) He shall check for the status of the enterprise and its coverage. (ii) Schedule VI and Sec – 22 of MSME requires disclosures in Financial Statements, so the same needs to be checked, (iii) Obtain list of suppliers and verify them, (iv) Verify the interest payable to parties thoroughly.}

- **Particulars of Payments Made to Persons Specified Under Section 40A(2)(b):** {*The auditor has to obtain a list of all the persons who are related to the assessee and scrutinise their ledger accounts.*}
- **Amounts Deemed to be Profits and Gains Under Section 33AB or 33ABA or 33AC:** This Clause relate to the provisions for the specified businesses. The assesse has to deposit some amount every year and whenever he withdraws it, he shall use the same for the business and utilise it completely in that year of withdrawal itself. If the amount is not utilised in that year then the same is treated as income and reported under this Clause. {*The auditor has to check out the amount of drawings made during the year. He shall check out for all the vouchers and supporting`s which help the auditor in knowing the genuineness of the expenditure.*}
- **Any Amount of Profit Chargeable to Tax Under Section 41 and Computation Thereof.** {*The Auditor has to obtain a list of all the amounts chargeable to tax under this Section along with relevant evidences, which needs to be checked with the relevant ledger accounts starting from the beginning till date.*}
- **Amount Disallowable/ Allowable Section 43B:** the disallowances made during the preceding previous year, which is eligible for deduction in the current previous year on payment basis and the details of the amount debited in current year's account but not paid during the current previous year and also before the due date of filing of the return.
- Particulars of income or expenditure of prior period credited or debited to the profit and loss account.
- Details of any amount borrowed on hundi or any amount due thereon (including interest on the amount borrowed) repaid, otherwise than through an account payee cheque [Section 69D].
- Particulars of each loan or deposit in an amount exceeding the limit specified in Section 269SS taken or accepted and also particulars of each repayment of loan or deposit in an amount exceeding the limit specified in Section 269T made during the previous year and whether the loan or deposit was taken or accepted or repayment was made otherwise than by an account payee cheque or an account payee bank draft.
- Details of brought forward loss or depreciation allowance in a prescribed format and whether a change in shareholding of the company has taken place in the previous year due to which the losses incurred prior to the previous year cannot be allowed to be carried forward in terms of Section 79. The auditor has to check all the previous years return of income, their assessment orders, revisional or rectification orders to find out the above amounts. The auditor has to verify the

register of members and their shareholding records to confirm if there are any changes in ownership.

- Section-wise details of deductions admissible under Chapter VIA.
- Default in compliance to the provisions of Chapter XVII-B regarding deduction of tax at source and regarding the payment thereof to the credit of the Central Government.
- The quantitative details of principal items of goods traded in trading concern and quantitative details of the principal items of raw materials, finished products and by-products in respect of manufacturing concern along with percentage of yield of finished products and shortage/ excess, if any.
- Details of tax on distributed profits under Section 115-O in the case of a domestic company. The date of declaration and payment of tax has also to be given too.
- Whether any cost audit or any audit was conducted under the Central Excise Act, and to enclose a copy of the report of such audit.
- **Accounting Ratios:** GP, NP, Stock Turnover, Material consumed/ Finished goods ratios with calculations thereof.

6. USE OF AUDITOR'S QUALIFICATIONS IN ASSESSMENT PROCEEDINGS

6.1 Qualifications in the Auditors' report provide relevant information for the assessee's assessment. All material facts affecting the fairness and truthfulness of the Balance Sheet and the profit & loss accounts are supposed to be contained in the qualifications in the Auditors' report. A report stating that sundry debtors and creditors are subject to confirmation, should give a clue to the AO that sundry debtors and creditors may have to be further scrutinized during the assessment proceedings. Qualifications of the Auditors' report should be thoroughly pursued to see their implication on the computation of income. In this regard, the specific check points are as under:

- Importantly, for an Assessing Officer who is introduced to the case file for the first time, the auditor's report provides a first-hand view on the nature, type, size and state of the business.
- The AO must verify if the deficiencies pointed out in the audit report have been reflected in the Computation of Income of the assessee. Else, the AO must add/ disallow the amount mentioned in the Audit Report and initiate penal action, if required.
- The AO should also examine the depreciation chart in Form 3CD and make sure that the assessee has claimed depreciation only as per the provisions of the income-tax Act and not as per the Companies Act. Excess of depreciation as per Companies Act over income-tax Act must be added back by the assessee in the Computation of Income.
- The year on year comparison of profit ratios provide an insight into changing nature of the assessee's business, if there is a substantial drop or sudden rise, the same may be examined critically.
- AO should also check for any loan taken or repaid, which violates the provisions of Section 269SS or 269T. Overlooking the same is very common and must be avoided.

- Change in shareholding pattern, issuing of shares at a premium and other issues may be examined in line with the provisions of Section 56(2)(viib) read with Rule 11UA.
- In case of amalgamation, merger, de-merger, the assessee's depreciation schedule maybe examined, to check for any new asset, in the form of good will or otherwise, that the assessee has shown to have arisen as a result of such scheme, and the claim of depreciation on the same under the provisions of the Act needs to be checked. The audit report is supposed to comment on the method of valuation/ re-valuation of any such asset and the allowability of the depreciation on the same.

6.2 If any material discrepancy is found in the books of account during the course of the assessment proceedings, and this is not mentioned in the Auditors' report, it may be necessary to examine whether the matter needs to be reported to the Institute of Chartered Accountants of India, for a possible inquiry into professional misconduct by the concerned Auditor.

CHAPTER

13

Cost Audit

A new Companies Act, 2013 replaced the old Companies Act, 1956 and has made comprehensive provisions to govern all listed and unlisted companies in the country. The significant changes inter-alia includes the provisions related to governance, e-management, compliance and enforcement, disclosure norms, auditors and mergers & acquisitions. By virtue of Section 148 of the 2013 Act [Section 209 under 1956 Act], the Cost Audit has been mandated for certain Companies. Further details about the Cost Audit in the 2013 Act are as under:

1. Under Section 148(1) of the Companies Act, 2013, Central Government is empowered to notify compulsory maintenance of prescribed cost accounting records by companies engaged in manufacture of certain specified items.

2. Cost accounting is materially different from financial accounting, because, in cost accounting, special emphasis is placed on collecting and studying data relating to accumulation of cost at every stage of the production process. Therefore, the subject of cost accounting also includes areas like work organisation, management, workmanship, engineering technique/ process, besides the cost of raw materials, consumable goods, utilities, and labour costs. In a manufacturing concern, cost accounting helps in finding out cost of production at every stage of production process, as the raw material passes through various stages of production. Therefore, cost accounting records have a direct relevance in assessing the utility of an input, or of labour, maintenance of stock inventory levels, and position of goods in production. Systematic maintenance of such records provides a continuous check on effective utilisation of the resources represented by raw materials, labour and semi-finished raw materials, etc.

3. Costing and preparing cost sheets and the relevant records for proper cost accounting, involves following steps:

- Understanding the layout of Plant and machinery and the systems flow chart in the factory.
- Understanding the various stages of manufacturing process from procurement of raw materials to packing of finished goods.
- Listing the ingredients of raw materials and consumable stores that go to make the finished goods, as also the utilities, like electricity, steam and water, for the manufacturing process.
- Understanding the levels of efficiency and quality of work force involved, and their full utilisation at each stage of production process.

- If the final product can be made by more than one method, or more than one formula, enlisting all such formulae and methods.
- Calculating the process loss that can be foreseen at each stage, identifying the normal or unavoidable loss and abnormal or unforeseen loss.
- Correlating the manufacturing process with the industrial parameters and finding if any alternations are required in the steps mentioned above.

4. COST AUDIT RULES

4.1 The Central Government issued Companies (Cost Records and Audit) Rules, 2014 on June 30, 2014. Subsequently, it issued Companies (Cost Records and Audit) Amendment Rules, 2014 on December 31, 2014. The Amendment Rules has introduced certain changes to the original Rules issued on June 30, 2014. The Companies (Cost Records and Audit) Rules, 2014 read with the Amendment Rules 2014 are now applicable and governs the maintenance of cost accounting records and cost audit as per Section 148 of the Companies Act, 2013.These provide that, every Cost Auditor appointed in a company to which Section 148 of the Companies Act applies, will submit Cost Audit Report, in Form CRA-3, to the Central Government, within 180 days from the close of the company's financial year. Rule 6 of these rules, requires maintenance of specified Cost Accounting records by such companies, and their submission to the Cost Auditor. These records must be such, as are adequate to determine the cost of production of the specified product/ goods. The various components of cost of production are analysed from costing accounting records relating to:

- Raw Materials
- Labour
- Depreciation
- Overheads
- By-products
- Scrap, waste materials
- Others e.g. royalty, technical know-how fees, other abnormal or non-recurring costs.

4.2 Rule 6 of the Companies (Cost Records and Audit) Rules, 2014: provides that a Cost Auditor shall submit a certificate as per Rule 6(1A). The other provisions are:

1. The company shall within 180 days of the commencement of every financial year, appoint cost auditor.
2. The auditor shall be informed about his appointment and notice of his appointment shall be filed within 30 days of his appointment in Form CRA-2.
3. **Tenure of Cost Auditor:** Every auditor shall continue his office till the expiry of 180 days from the closure of the financial year or till he submits his cost audit report.
4. **Removal of Cost Auditor:** Cost Auditor may be removed before expiry of his term, through a board resolution after giving him reasonable opportunity of being heard.
5. **Casual Vacancy:** Any casual vacancy of cost auditor whether due to resignation, death or removal, shall be filled by board of directors within 30 days of such occurrence and company shall inform CG in E-Form CRA-2 within 30 days of appointment of cost auditor.
6. **Signing of Cost Statements:** Cost Statements to be annexed to the cost audit report, shall be approved by the Board of directors before signing on behalf of the board by any director, for submission to the cost auditor to report thereon.
7. **Cost Audit Report:** Cost Audit Report shall be made in form CRA-3 and shall be forwarded to Board of Directors within a period of 180 days from the closure of the financial year.
8. **Filing with ROC:** Cost Audit Report shall be filed in XBRL format within 30 days of receipt of report in E-Form CRA-4.
9. **Applicability of Section 143 (12) (Fraud Reporting):** The provisions regarding disclosure of fraud by auditor in its Audit report under Section 143(12) shall be applicable to Cost Auditor.

5. INFORMATION IN COST ACCOUNTING RECORDS

5.1 The Cost accounting records and Cost Audit report contain information relating to the following:

- The date of commencement of commercial production;
- The exact process of manufacture, with details of raw materials, finished goods, by-products and waste materials;
- Details of foreign collaborations, etc.;
- Details of activities other than the manufacture of the main product(s).
- Actual production of each item of finished goods, bye products and waste materials;
- The various components of the cost of production.

6. INFORMATION GIVEN IN COST ACCOUNTING REPORTS

6.1 General: Information regarding name and addresses of the company, location of factory, date of commencement of commercial production and other activities of the company, is given.

6.2 Cost Accounting System: This describes the cost accounting system followed, and the correctness of cost of production of the product. The Auditor is required to give specific comments on the adequacy of the cost records, the inventory valuation system of raw material, work-in-progress, and finished products.

6.3 Financial Position: Under this head, the Auditor has to certify the average of fixed assets at net book values, and current assets minus current liabilities, existing at the beginning and close of the financial year, for the company as a whole, and for the product under reference.

6.3.1 Net worth of the company has to be highlighted. The Profit of the enterprise as a whole, and Profit for each of the product under reference, has to be reported separately. The Auditor has to certify the Net sales, Operating Profit and Value additions.

6.3.2 The Auditor is also required to work out Financial ratios in respect of profit, net sales, current assets to current liabilities, net worth to capital employed, net worth to long term borrowing.

6.3.3 The Auditor has to furnish following information in respect of the production capacity.

- Licensed/ registered capacity
- Installed capacity
- Production capacity enhanced by leasing etc., with details of added capacities and other utilisations.
- Actual production.
- Percentage of production to installed capacity.

7. NOTES IN COST AUDIT REPORTS

7.1 Details of installed capacity are on single shift or multiple shift basis.

7.2 Production and installed capacity expressed in appropriate units, e.g., standard hours or equipment/ plant/ vessel, occupancy hours, crushing hours, spindle/ loom shifts, etc. If there is any shortfall in production compared to the installed capacity, comments are required to be given on the reasons for the shortfall, bringing out clearly the extent to which they are controllable in short-term as well as long term.

7.3 Process of manufacture is to be described along with a flow chart.

7.4 Details of raw materials used are to be given, indicating any significant cost of transport. In case of imported raw material, FOB value, ocean freight, insurance, custom duty and inland freight charges are to be indicated. In case of consumption of both indigenous and imported materials, Auditor has to report the percentage mix of the same.

7.5 Quantity-wise consumption of major raw materials, standard requirement, as well as theoretical norm per unit of production in terms of quantity, has to be reported.

7.6 The Auditor is required to give particulars of consumption of power and fuel, and comment on any variation from standard/ budgeted norms.

7.7 Explanation for any variations in the quantity of major raw materials consumed as compared to standard consumption has to be obtained and commented upon.

7.8 Auditor has also to indicate the value of raw materials, finished goods and semi-finished goods, which have not moved for over 12 months, and also their proportion to the value of closing stock.

7.9 Particulars of wages and salaries are to be classified as under-

- Direct labour costs on production;
- Indirect employee costs of production;
- Employee costs on administration;
- Employee costs on selling and distribution;
- Other employee costs, if any (specifying purpose);
- Total employee costs;
- Total man-days of direct labour available and actually worked during the year.
- Average number of workers employed during the year.
- Direct labour cost per unit of output of each of the products.
- Brief explanation for variation if any, as compared to the previous two years.
- Comments on the incentive schemes, if any, with particular reference to its contribution towards increasing productivity and its effect on cost of production.

7.10 As regards repairs and maintenance, the Auditor has to report stores, spares, labour charges and outside contract repair charges and their proportion to closing inventories.

7.11 Depreciation has to be calculated as per Companies Act.

7.12 The Auditor has to report cost of factory overheads, administration overheads, selling overheads and distribution overheads, and has to indicate reasons for any significant variations.

7.13 The Auditor has to clarify whether gross sales realisation includes cost of packing, freight and delivery charges, are recoverable from the customers.

7.14 Any abnormal, and non-recurring costs e.g. strikes, lockouts, power cuts and serious accidents, etc. are to be reported.

7.15 Final observations and conclusions of the Auditor are to be given in respect of any negligent use of funds, carelessness resulting in increase in cost of production, the effectiveness of the budgetary control system, etc. The Auditor is also required to give suggestions for full utilisation of the installed capacity, cost reduction, increase in productivity, and improvement of inventory policy.

7.16 After examining the books of accounts, statements of reconciliation and financial statements, etc., the Auditor has to certify the overall results of the company.

8. THE RELEVANT FORMS UNDER COST AUDIT RULES FOR FILING WITH THE ROC ARE AS UNDER

S. No.	Form No.	Description
1	CRA-1	Form in which Cost records shall be maintained
2	CRA-2	E-Form for intimation of appointment of Cost Auditor by the Company
3	CRA-3	Form of Cost Audit Report
4	CRA-4	E-Form for filing Cost Audit Report with Central Government

9. The assessing officers dealing with manufacturing assesse, or in cases where they receive information from excise or GST authorities, or in cases where the results of the Company is at variance with other concerns in same line of manufacture and lower incomes are offered to tax, OR where lot of subsidy payments like in fertilizer industry are involved, should enquire about applicability of cost accounting norms and get the reports.

CHAPTER 14

Special Audits

The Income-tax Act, 1961 requires the assessees to file various types of audit reports/ certificates in specified forms. The various reports/ certificates and the corresponding forms prescribed for filing are as under:

Particulars	Type	Section of the Act	Rule of the Income-tax Rules, 1962	Form
Public Charitable Trusts or Institutions	Audit	12A	17B	10B
Fund or trust or institution or any university or other educational institution or any hospital or other medical institution	Audit	10(23C)	16CC	10BB
Electoral Trust	Audit	13B	17CA	10BC
Assessee claiming deduction in respect of profits and gains from **newly established small-scale industrial undertakings** in certain areas	Audit	80HHA	18BB	10CC
Assessee claiming deduction in respect of profits retained for export business	Report	80HHC	18BBA(2)	10CCAB
Assessee claiming deduction in respect of profits retained for export business	Report	80HHC	18BBA(3)	10CCAC
Assessee claiming deduction in respect of earnings in convertible foreign exchange	Report	80HHD	18BBA(4)	10CCAD
Assessee claiming deduction in respect of profit & gain from export or transfer of film software	Certificate	80HHF	18BBA(9)	10CCAI
Assessee claiming deduction in respect of profits and gains from industrial undertakings or enterprises engaged in infrastructure development	Audit	80-IA	18BBB	10CCB
Assessee claiming deduction in respect of profits and gains from certain industrial undertakings **other than** infrastructure development undertakings. **MULTIPLEX THEATRE**	**Audit**	**80-IB**	18DB	10CCBA

Particulars	Type	Section of the Act	Rule of the Income-tax Rules, 1962	Form
Assessee claiming deduction in respect of profits and gains from certain industrial undertakings **other than** infrastructure development undertakings. **CONVENTION CENTRE**	Audit	80-IB	18DC	10CCBB
Assessee claiming deduction in respect of profits and gains from business of hotels and convention centres in specified area	Audit	80-ID	18DE	10CCBBA
Assessee claiming deduction in respect of profits and gains from certain industrial undertakings **other than** infrastructure development undertakings **HOSPITAL** **April 2008-March 2013**	Audit	80-IB	18DDA	10CCBD
Assessee claiming deduction in respect of certain incomes of **Offshore Banking Units** and **International Financial Services Centre**	Report	80LA	19AE	10CCF
Deduction in respect of employment of **new employees**	Report	80JJAA	19AB	10DA
Foreign Remittances	Certificate	195	37BB	15CB
Any assessee who has short deducted tax or failed to pay such tax	Certificate	201	31ACB	26A
Any assessee who has collected short tax or failed to pay collected tax	Certificate	206C	37J	27BA
Assessee being a company to whom "Minimum Alternate Tax" provisions are applicable	Report	115JB	40B	29B
Assessee being a non-company assessee to whom "Alternate Minimum Tax" provisions are applicable	Report	115JC	40BA	29C
Investment Deposit Account	Audit	32AB	5AB	3AAA
Assessee carrying on business of growing and manufacturing tea or coffee or rubber in India	Audit	33AB	5AC	3AC
Assessee carrying on business consisting of the prospecting for, or extraction or production of petroleum or natural gas or both in India	Audit	33ABA	5AD	3AD
Amortisation of certain preliminary expenses	Audit	35D	6AB	3AE
Deduction for expenditure on prospecting, etc., for certain minerals	Audit	35E	6AB	3AE
Audit of accounts of certain persons carrying on business or profession	Audit	44AB	6G	3CA/ 3CB/ 3CD
Assessee being a non-resident and having income by way of royalty or fees for technical services received from Government or an Indian concern	Audit	44DA	6GA	3CE
Assessee undergoing slump sale transaction for the purpose of computation of capital gains	Report	50B	6H	3CEA
Assessee entered into international transaction or specified domestic transactions (Transfer Pricing)	Audit	92E	10E	3CEB

Particulars	Type	Section of the Act	Rule of the Income-tax Rules, 1962	Form
For determination of arm's length price in respect of the remuneration paid by an eligible investment fund to the fund manager.	Report	9A	10V	3CEJ
Assessee, being a company engaged in the business of bio-technology or in any business of manufacture or production of any article or thing	Report	35(2AB)	6(7A)	3CLA
Certifying income attributable to assets located in India	Certificate	9(1)(i)	11UC(2)	3CT
Assessee, being newly established undertaking in free trade zone; to certify that the deduction has been correctly claimed	Report	10A	16D	56F
Assessee, being newly established 100% Export Oriented Units, to certify that the deduction has been correctly claimed	Report	10B	16E	56G
Assessee, being an undertaking exporting eligible products outside India	Report	10BA	16F	56H
For payment/ expenditure directly incurred by company qua eligible projects/ schemes from chartered accountant	Certificate	35AC	11-O(2)	58B
In case of amalgamated company, certificate relating to achievement of the prescribed level of production and continuance of such level of production in subsequent years	Certificate/ Verification	72A(2)	9C	62
Statement of income paid or credited by Venture Capital Company or Venture Capital Fund	Certificate/ Verification	115U	12C	64
Statement of Income Distributed by a business trust	Report	115UA	12CA(2)	64A
Tonnage tax Company	Report	115VW	11T	66
Special Audit	Audit	142(2A)	14A	6B

2. PENALTY FOR FURNISHING INCORRECT INFORMATION IN REPORTS OR CERTIFICATES

The Finance Act, 2017 has inserted Section 271J in the Act which empowers the AO and the Commissioner (Appeals) to impose a penalty of a sum of Rs. 10,000/- upon an account or a merchant banker or a registered valuer for furnishing incorrect information in any report or certificate furnished under any provision of the Act or the rules made hereunder for each such report or certificate.

3. TAX AUDIT REPORT *U*/S 44AB OF THE ACT

3.1 The most common and important audit report which needs to be filed by various assessees is the tax audit report under Section 44AB of the Act. This Section makes it obligatory for person carrying on a business or profession and having a turnover exceeding the specified amount, to get his accounts audited by Chartered Accountant and to furnish by specified date, a report of such audit, in a prescribed Performa .

3.2 The objective of this Section, as clarified in Circular No. 387 dated July 6, 1984, is to ensure

that the books of accounts and other records are properly maintained by the assessee's so that they correctly reflect their true income. The tax audit facilitates the AOs by ensuring the presentation of the accounts in a proper format and saving time in carrying out routine verifications.

3.3 The tax audit report under Section 44AB of the Act is applicable for the following persons:

1. Every person who carries on business and whose annual gross receipts exceeded Rs. 1 crore;
2. Every person carrying on profession if the annual gross receipts exceeded Rs. 50 lakhs.

Apart from the above, Section 44AB also provides for certain other situations falling under the presumptive scheme of taxation where the assessee is required to get a tax audit report. With effect from AY 2017–18, tax audit under Section 44AB shall not apply to an assessee whose annual gross receipts from the business exceed Rs 1 crore but do not exceed Rs 2 crores, if he declares profits as per the presumptive taxation scheme under Section 44AD.

3.4 Submission of Information by the Assessee: The Auditor is required to obtain and include various particulars in the audit report, in the prescribed Form No. 3CD. The information obtained by the Auditor is normally more comprehensive and exhaustive, than what is included in the Audit. This enables the Auditor to make proper verification and ensure that true and correct information is submitted to the Department in the Audit report.

3.5 Test Checks: While test checks may normally suffice to certify whether the accounts depict a true and fair view, even then the Auditor may be required to apply reasonable tests for checking the information submitted by the assessee, as the Auditor has to ensure that no items have been omitted in the information furnished. The extent of checking needed has to be indicated by the Auditor in his working papers and audit notes.

3.6 Working Papers: Section 143 of the Companies Act, 2013 gives certain powers to Auditors to call for the books of account, information, documents, explanations, etc. and to have access to all books and records. However, no such powers are given to the Auditors appointed *u/s* 44AB. Even then, since the appointment of the Auditor is made by the assessee himself, it is in the interest of both that the assessee furnishes all the information and explanation and produces the various books of account and records called for by the Auditors. However, if the assessee refuses to produce any particular record, or to give any specific information or to explain any issues, then as per the guidance note on tax audit published by the Institute of Chartered Accountants of India, the Auditor should report the same and qualify his report accordingly. The working papers are the most important evidence of the work done by the Auditors. Various publications of the Institute of Chartered Accountants have repeatedly emphasized upon the need to preserve the working papers. In the "Guidance Note on Tax Audit" it has been emphasized that in order to be in a position to explain any question which may arise later on, the Auditor should keep and maintain detailed notes about the evidences on which he has relied upon while conducting the audit. The Auditors have also been advised to maintain all their working papers which should include notes on the following, amongst other matters:

- What work was done while conducting the audit and by whom?
- What explanation and information were given to him during the audit and by whom?
- What decision on various points were taken, and
- Which of the judicial pronouncements were relied upon by him before giving the audit report.

The certificates obtained from the management are supposed to be kept by the Auditor.

3.6.1 It is necessary for the Auditor to ensure that before expressing his opinion he should have adequately satisfied himself as to the authenticity of the information being certified by him and to ensure that his working papers and documents are adequate and enable him to certify such particulars. The liability of the Auditors in respect of tax audit is the same as in the case of any other audit assignments. Where any question relating to the audit conducted by the Auditor arises, he is answerable to the Council of the Institute under the Chartered Accountants Act and in all matters pertaining to tax audit, its disciplinary jurisdiction prevails. In cases where the AO comes to the conclusion that the Auditor was grossly negligent in the performance of his duties, then action can be taken against the tax auditor under the Chartered Accountant's Act. The AO or any other authority who is authorised to issue summons and to call for evidence or document can call the Auditor, who had audited the accounts, to give any evidence or to produce the documents called for.

4. SPECIAL AUDIT *U*/S 142(2A) OF THE ACT

4.1 As per the provisions of Section 142(2A), the AO may,

- At any stage of proceedings before him, having regard to the nature and complexity of the accounts, volume of the accounts, doubts about the correctness of the accounts, multiplicity of transactions in the accounts or specialized nature of business activity of the assessee, and in the interests of the revenue,
- And with the previous approval of the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner of income-tax,

direct the assessee to get his accounts audited by an "accountant". Such "accountant" shall be nominated by the Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner.

4.2 The scope of the power of the AO to direct a special audit was enhanced by the Finance Act, 2013 by inserting following additional grounds on which a special audit can be directed:

- Volume of the accounts;
- Doubts about the correctness of the accounts;
- Multiplicity of transactions in the accounts; or
- Specialized nature of business activity of the assessee.

The constitutional validity of these amendments was upheld by the Hon'ble Delhi High Court in the case of *Sahara India Financial Corporation Limited vs. CIT* (2017) 84 taxmann.com 225. This judgement has discussed in detail the relevant aspects in connection with the circumstances in which the AO can direct a special audit *u/s* 142(2A) of the Act.

4.3 The assessee has to furnish a report of such audit in Form No. 6B duly signed and verified by such "accountant" setting-out such particulars as may be prescribed or as to the AO may require. The AO can call for such a report even though the accounts might have been audited under any other law. The report has to be furnished by the assessee to the AO within such period as may be specified by the AO.

4.4 The CBDT has issued Instruction No. 1076 dated 12.7.1977 setting out following guidelines for selection of cases for special audit *u/s* 142(2A).

- There are reports of misfeasance, gross neglect or breach of duty on the part of the principal officer or director in relation to the affairs of the company; or

- The company's affairs have been the subject of search or seizure under the income-tax Act or been the subject of a probe under FEMA/ PMLA/ other enforcement agencies; or
- The company has foreign collaboration arrangements; or
- The company principal is a foreign company and deduction of Head office expenses etc. have been claimed; or
- The company has import/ export business with a yearly turnover of more than a crore of rupees; or
- There are allegations of substantial tax evasion; or
- Cases involving large ramifications - due to inter-branch transfers; or as a result of setting up of several intermediaries such as purchasing agents, distributing and selling organisations, advertising agents etc; or
- The AO has any other information necessitating a special audit.

4.5 It is mandatory for the Assessing Officer to allow a reasonable opportunity to being heard before the matter is referred for Special Audit. The Courts have often quashed the order of Special Audit where no prior opportunity was given to the assessee. It is, therefore, desirable that the Assessing Officer should first identify the 'Terms of References' on which the Special Audit is proposed and issue a show cause notice to the assessee with specific reference to those Terms. The work for Special Audit has to be assigned to the Accountant who is empanelled for this purpose by the Chief Commissioner.

4.6 The expense for Special Audit is now required to be paid by the Department. Rule 14B of the I.T. Rules prescribes the guidelines for determining the expenses for Audit. The remuneration payable to the Accountant & the qualified assistant, semi qualified and other Assistants engaged by the Accountant as prescribed varies in the range of minimum of Rs. 3750/- to maximum of Rs. 7500/- per hour. The remuneration claimed by the Special Audit is often subject to dispute and the matter has also travelled to Courts. The Accountant is also required to maintain a time sheet which is to be submitted along with the bill. While allowing the claim for remuneration of the Special Auditor, one has to ensure that the number of hours claimed for billing purpose is commensurate with the size and quality of the report submitted by the Accountant. In order to avoid any litigation at a later stage, the Assessing Officer may prescribe the rate of remuneration in the order of Special Audit itself. Further, the work of Special Audit needs to be periodically reviewed to ensure that the time as spent is commensurate with the work carried on.

4.7 The power of Special audit *u/s* 142(2A) is a very important and potent tool of investigation in the hands of the AO for a professional examination of accounts and records, in complicated cases. This should be Utilised in serious investigation cases. It is always advisable to frame specific issues arising in a given case, on which the opinion of the Auditor may be called, in addition to the Performa audit report.

CHAPTER

15

Investigation of Bank Accounts

1. A common fallacy among many investigators and judicial authorities is that amounts in bank accounts are accounted and it does not represent any "black money". It is a misconception as money in bank account does not necessarily mean money on which due taxes were paid. Therefore, investigation of bank accounts is to verify whether all the deposits made in that account were considered for arriving at total income and on which due taxes were paid.

2. Many assessees use banking channels to conceal their income, or to introduce their unaccounted income in the books of accounts in the form of unsecured loans, share application money, share capital, and for inflating their liabilities/ expense.

3. A proper investigation of transactions routed through bank accounts, requires certain basic knowledge of the practices followed and procedures followed by banks. These are now described below.

4. RECORDS KEPT BY BANKS

4.1 Today the Most Important linkage number is CUSTOMER ID. All bank customers are assigned an unique number to which all accounts, credit cards, debit cards are linked. Even net banking is enabled through this number only as one of the inputs apart from the password. The following records are maintained by banks. The Know Your Customer (KYC) norms and relevant documentation is bedrock of the customer ID.

The customer ID is generated after the account opening form as per mandated KYC norms is received. The customer ID is unique and banks use this as a common link key. So all accounts of that person, wherever they are, all credit cards and debit cards and even all loan accts get linked by this customer ID. The AO can, therefore, access all these with the customer ID.

As part of efforts to unearth other related accounts, The AO should also look for other customer IDs bearing same address as the "a". Generally different customers IDs are generated for same person if different document of identification is given along with KYC. For example, if at one place passport is given then one customer ID will be generated and if next time some other identity proof is given new customer ID will be generated. Therefore, detail inquiry is required to be carried over.

4.2 Account Opening Forms- All constituents of banks, whether opening a Saving Bank (S/B) account, or a Current Account (C/B), or Fixed deposit Account, have to fill an account opening form, which has following details:

- Name & Address of the customer with supporting address proof and in many cases the Aadhar number.
- The account number and name of the introducer.
- Details of other accounts of the same assessee kept with the same branch.
- Nature of bank account, i.e. S/B, Current, Single name, Joint Name, etc.
- Name of persons authorised to operate it.

4.3 Locker Register: This gives particulars of the lockers maintained in that bank, with details of dates on which it was operated.

4.4 Fixed Deposit Register: All banks keep a separate register of FDRs. A verification of the FDRs and its closure entries in the register would reveal how the FDRs have been opened and how the funds have been transferred after closing the accounts. Any FD over Rs. 50,000/- can be closed only by crediting SB Account. This register is now digitally maintained.

4.5 Clearing Register: This register gives details of cheques received from other banks in the same city (inward clearing) and cheques going from particular bank to all the other banks in the same city (outward clearing). This register is very important in tracing the origin of credits as well as tracing the last point of debits. Now the cheque is not presented physically but only magnetic image is sent for clearing. RBI, SBI or a designated branch of a bank is entrusted with the clearing work. So tracking of clearing cheques can be done from the office which is conducting clearing.

4.6 OBC Register: This register contains details of cheques sent and received for collection from other towns to this branch. A careful examination of cheques received and collected through outside branches, to the assessee's account may throw light on the accounts maintained by the assessee in places other than the principal place of business.

4.7 Slip Bundles: Every bank branch keeps a slip bundle containing the slips/ cheques relating to each day's transactions. This is arranged in a particular order such as SB, CD, OD, DD, etc. These bundles are to be kept by the bank for a minimum period of 8 years. The verification of slip bundles can provide key information about the date/ nature of transaction and the parties involved.

5. TYPES OF BANK ACCOUNTS

5.1 Saving Bank Accounts: These bank accounts are generally opened by individuals for depositing their savings. Withdrawals from these accounts can be made through withdrawals slips or through cheques.

5.2 Current Accounts: These accounts are generally opened for the transactions of the business. The withdrawals from these accounts can be made by issuing cheques. Overdraft facility can also be allowed by the bank against certain securities.

Details of securities may also be examined to find out assets and there source to.

5.3 Cash Credit Accounts: These are loan accounts, from which withdrawals upto the limit sanctioned by the bank, against some security, are allowed.

Basis for Comparison	Cash Credit	Overdraft
Meaning	Cash credit is a type of short term loan provided to companies to fulfil their working capital requirement.	Overdraft is a facility given by the bank to companies, to withdraw money "more" than the balance available in their respective accounts.
Security	Pledge or hypothecation of inventory.	Assets like financial instrument and property.
Account	Cash Credit Account	Current Account

It is advisable to find out the securities, margin against which Cash Credit (CC) limit is sanctioned.

5.4 Fixed Deposit Accounts: These accounts are opened for depositing an amount for a fixed period. Different names are given to such accounts in different banks, such as FDR, TDR, STDR, Deposits receipts etc. These accounts are used by the individuals and also by the business houses.

6. DEPOSITS IN BANK ACCOUNTS

Though the procedure is well known, it is important to know the entries made by the dealing clerks/ bank officials for any detailed examination tomorrow.

The standard pay-in-slip forms are issued by banks in booklets, for depositing money in the bank accounts. Some banks use a single type of form for depositing both cash and cheques. The description of the cheque and denomination of the cash deposited has to be given on the pay-in-slip itself. The pay-in-slip has two parts, the deposit slip and its counter foil.

The cashier after verification of the cash deposited, enters the full particulars of the account and the denomination of the cash received, in the cash receipt scroll maintained by him, in chronological order. Thereafter, he signs the counter foil of the pay-in-slip and returns it to the person depositing the money as a token of having received the cash. The cashier also writes the serial number of the scroll on the pay-in-slip and places a rubber stamp of "cash received" on the pay-in-slip and signs it. The details are then entered into the banking accounting system that is computerised in most of the branches.

A careful analysis of pay-in-slips can also reveal the identity of the person who visited the bank for making the deposits. Any cheques/ drafts received by the account holder can also be deposited through pay-in-slips for collection.

The details of the pay-in-slips through which cheques and demand drafts are received are then entered in the subsidiary books of the bank, according to the nature of cheques/ drafts. The cheques issued from another account of the same bank or the drafts drawn on the same bank are recorded on the transfer scroll. Similarly, the cheques drawn on other banks are written in the scroll maintained for the clearing, and these are then presented for clearing at the clearing houses. All these registers are now computerised.

By examining pay-in-slips, one can also ascertain the branch of cash deposit which can be used to counter the assessee's argument *viz.* cash received by sale in Mumbai on same day cannot be deposited in Delhi.

7. WITHDRAWALS FROM BANK ACCOUNTS

7.1 Any withdrawals from bank accounts can be made by cheques; or by withdrawals slips; or by standing instructions. The method generally adopted for making payments or withdrawing the money is by issuing cheques. The identity of person withdrawing cash from the bank can be found from the signature on the back side of the discharged cheque.

In many cases, where a cheque is issued to a benami concern, the signature of the recipient on the back side of the cheque, will be that of the assessee, or his employee. This form of cash withdrawal is very common, when expenditure is being inflated or bogus payments are being entered in books.

A withdrawal slip is used for withdrawing money from the savings bank accounts. The rubber stamp on the withdrawal slip indicates the nature of transactions such as cash/ transfer/ clearing, etc. The account holder can also give standing instruction to transfer certain sum of money regularly to some other bank account(s). He can also request for transfer of money by mail transfer or telegraphic transfer or even through phone banking or the internet banking facility. At

any rate, in all such transactions, the narration in the account copy is the only indicator about the transaction and the recipient.

7.2 Types of Cheques: In most of the cases, the withdrawal from the bank accounts are made through cheques. Therefore, it is necessary to understand the various types of the cheques and the crossings made on such cheques. The cheque leaflets are got printed by banks on security paper, which are then issued to their customers in booklet forms of 10, 20, 50, etc.

- **Bearer Cheques:** The "bearer" cheques can be encashed at the bank counter by any person presenting the cheque.
- **Order Cheques:** If the word "bearer" printed on the cheque, is cancelled, or even if any name is written, then it becomes an 'order cheque'. It can be encashed by the person in whose name it has been drawn. However, an order cheque can also be endorsed in favour of any other person, by the person in whose favour it was originally issued. Therefore, bank can make payment in cash against order cheques, only after ascertaining the identity of the person to whom the payment is to be made.
- **Crossed Cheques:** Both types of cheques can be "crossed", in which event payment against such cheques cannot be given in cash across the counter. The crossed cheques are to be deposited in the Bank accounts only. Following types of crossing are generally made on crossed cheques:

  * & Co.

  * Account Payee

  * Payees' account only

The crossing can be made on the cheque by drawing two parallel lines on the left hand corner of the cheque and by placing the appropriate words, out of the above three.

If the above crossings are made on a bearer cheque then it can be credited to the account of any person presenting the cheque.

If the crossing on the order cheque is "& Co." then the amount can be credited to the account of the person, in whose favour it is drawn or in the account of the person, in whose favour it has been endorsed.

If the order cheque is having the crossing of "Account Payee" or "Payees Account only" then the cheque can be deposited only in the account of the payee in whose favour it has been originally issued.

Payments by cheques lead to a normal presumption that the transactions are genuine and bona fide. Taking advantage of this presumption assessees sometimes issue cheques even in respect of bogus payments to give them a colour of genuineness.

When a payment is made by a bearer cheque, it may well happen that the assessee's own employee goes to the counter, encashes the cheque and brings back the money. A scrutiny of the endorsements, particularly the last of the endorsements in respect of cheques which are suspected to be for bogus purchases, expenses etc. might reveal that amounts which are shown as having been paid to a certain person had actually been received (across the counter) by the assessee himself or a trusted employee.

8. ILLUSTRATION

In order to give a colour of reality, an assessee had credited the account of 'X' for various payments due to be made to him for work done.

'X's account was debited for payments made and these were made by cheques. There was thus very little reason to doubt the genuineness of this account. However, other circumstances indicated that the so-called work could not have been done and if this inference was correct, the account could not be genuine. Therefore, to establish correct facts, all cheque-foils for payments debited to this account were called from the bank and examined. The first payment was for a small sum of Rs. 200 and was made by

crossed order cheque. This cheque had, therefore, gone to the credit, of 'X's account. Other cheques were found to be bearer cheques and encashed by an employee of the assessee. Therefore X's account with the bank and his current account opening form were called for from the bank. A summons was issued to 'X', but it was found that no person by the name 'X' existed at the address given. This indicated that the account in the name of 'X' was a pseudonymous account. The account opening form was examined and the person who had introduced this account was summoned. He stated that he did not know 'X' at all. However, he admitted that he knew the assessee, and stated that, to his knowledge he had not signed any current account opening form for him, nor had he introduced any account in his name as the assessee was a big party. Specimen signature of the witness was obtained and compared with the signature on the account opening form. They were found to be absolutely dissimilar. It transpired that the signatures on the current account opening form, were forged to comply with the requirements of the Bank. This established that the whole account was bogus and the inference arrived at from circumstantial evidence that the work was not done was correct.

Further, one can also verify the genuineness of transaction by inquiring date of issue of cheque book by the bank to customer, *viz.* if assessee claims that he made certain expenditure on particular date and furnish copy of cheque then it can be inquired whether the same cheque was issued to the assessee by bank before that date or not.

9. TYPES OF ENTRIES IN A BANK ACCOUNT

9.1 With ATMs everywhere and with introduction of credit and debit cards and on line (net banking) as well as telephone banking transaction facilities, deposit and withdrawal of cash has become easy and one may not even know the identity of depositor or withdrawer. The account copy narration is the only source of details/ information in such cases. It would be illustrative to examine the backside of any ATM slip to see various abbreviations and meaning of such terms which all are various banking transactions possible on the ATM machine.

i. **"To Cash"** and **"By Cash"** respectively indicate withdrawal in cash, and deposit by cash.

ii. **"To Transfer"** indicate that the amounts have been withdrawn for transfer of that amount to another bank account with the same branch or for the purchase of fixed deposit, demand drafts, banker cheques or for transfer of money through telegraphic transfer or mail transfer.

iii. **"by Transfer"** appearing in a pass book may provide a clue to concealed bank accounts and/ or secret business activity. Bank Accounts at times are closed either by transfer or by drawing a cheque in favour of another bank, and the account in the latter may not have been disclosed by the assessee.

iv. **"To Clearing"** indicates that the cheque drawn from the account has been cleared through another bank normally in the same city, and has been deposited in the account with that other bank.

v. **OBC:** Outward bills for clearing, indicating credit received from banks which are outside the city/ town where the branch is located.

vi. **FIBC:** Foreign inward bills for collection, indicating export proceeds credited.

vii. **CP:** Cheque purchased, indicates instant credit to the party even before sending it for clearing or collection.

viii. **FD:** Fixed Deposit, maturing for amounts above Rs. 50,000/- has to be credited to an account and cannot be paid in cash.

ix. **CC:** Cash credit, indicates amounts received from loan account which are in the nature of cash credits.

x. **OD:** Overdraft, indicates amount credited on transfer from overdraft account.

xi. **MV:** Motor vehicle, indicates amount transferred from motor vehicle loan account.

xii. **Y/S:** Yourself, indicates amounts transferred from the account for purchase of DD, Pay Order or making fixed deposits in the same branch.

xiii. **MT/ TT:** Mail transfer and telephonic transfer, indicate transfer of funds through mail or telephone from outstation branch to this branch or from this branch to outstation branch of the same bank.

10. NEED FOR INVESTIGATION OF BANK TRANSACTIONS

10.1 The income-tax Act has made it mandatory that payments exceeding a specified amount cannot be made otherwise than by crossed cheques or bank drafts. Similarly repayment of loans also cannot be made otherwise then by account payee cheque. Which type of crossing needs to be made on the cheques is also given in some of the Sections. For example, Section 40A(3) specifies that the cheque should be a "Crossed Cheque". Similarly Sections 69D, 269SS and 269T specify the crossing to be as "Account Payee". Thus, to fulfill the requirements of the Act, specified type of crossing has to be made by the assessees on the cheques/ drafts. It is not specified in the Act as to whether the cheque has to be bearer or order. By making payments through cheques and giving the specific crossing, the assessees feel that they have fulfilled the legal requirements. In many cases the AOs also feel that the payments have been made or the amount have been received through cheque with the specified crossing, and therefore, the transactions are genuine. This presumption is not always correct. In many cases, a proper investigation of the transactions apparently routed through bank accounts, brings out a different picture.

10.2 The advantage of investigation of bank accounts lies in the fact that they offer documentary evidence by way of bank slips, registers, computer entries, etc., which are preserved for a minimum period of 8 years. These documentary evidences once gathered will stand the test of every appeal.

In cases of serious investigations of bank records, it may be advisable to visit the bank rather than issuing letters calling for information. A discussion with the bank manager about the assessee may bring forth valuable information, and provide an opportunity to verify the records available with the bank, such as slips, registers, loan files, etc. However, the nature of relationship between the bank and its customer, i.e. the assessee should also be borne in mind.

11. FOLLOW-UP OF CHEQUES

11.1 When during an investigation, it becomes necessary to scrutinise a cheque drawn by an assessee, the cheque-foil is obtained from the drawee bank. It will show whether it was a bearer or crossed or order. In other words, the cheque will show whether it has been cashed on the bank's counter or whether it has been credited to some other bank account or to the payee's own account. When it is cashed on the counter, the endorsement on its back-side will show the person to whom payment was made by the bank. In serious investigation cases, the AO will ordinarily have a list of persons in absolute confidence of the assessee/ management. If it is found that the assessee's own accountant or cashier had encashed the cheque at the bank's counter, the presumption that the transaction was bogus would become very strong, the assessee having withdrawn this cash through his employee. A transaction such as this has, therefore, to be explored in all its bearings from the financial as well as trading aspects to establish its real nature. Repeated transactions where payments made by bearer cheques are

encashed by assessee's own employees would help the AO to make out a convincing case that the transactions are bogus.

11.2 Delinquent assessees often employ more complicated and involved methods to hoodwink the Department. If an assessee has shown payments in respect of bogus transactions by crossed order cheques, the onus to prove the transactions to be bogus shifts to the AO He will have to collect clinching evidence for the purpose. Suppose an assessee has shown payment to 'X' for certain purchases, by crossed order cheque. The reverse of the cheque-foil would show the name of the bank which has been given credit by the drawee bank and the date of clearance. The AO should then inquire from the receiving bank (i.e. Payee) the account to which this amount has been credited, by giving them the particulars of the drawee bank, cheque number, amount and the date of payment or clearance. The receiving bank should also be asked to supply the name and full address of the person to whom credit is given, and if it is a firm, name and address of the person who is operating that account should be asked. It is not very unusual to find cases where the assessees open accounts in benami names, and operate the same through their nominees, immediate relations or employees. Unless this information is obtained from the receiving bank, the mere fact that the credit has gone to a bank account, would be meaningless. The attempt should be to pierce through the complicated fabric woven round these transactions and to see if it is linked with the assessee.

11.3 In a case, where the AO notices a credit in the bank account requiring scrutiny, he can call information from the bank regarding the cheque number, and the name of the bank on which the same is drawn. The date of encashment is already known to him from the pass book. With this information he can inquire from drawer's bank the name and address of the person who had drawn the cheque. Once the AO has in his possession information regarding the name and address of the person who had made this payment to the assessee by cheque and which is accounted for by him in his bank account, the AO can pursue his enquiries to find out the details of the transactions in respect of which this payment was made. Detailed enquiry regarding selected credits may lead to useful information indicating sale proceeds of investments or assets, sources of which may have hitherto been suppressed; or speculation or similar profits; or sales not accounted for, etc.

11.4 Illustration: An assessee engaged in manufacturing activities, was suspected of suppressing its production. Scrutiny of accounts indicated that it had transactions with a non-resident Company, 'Y'. Letters addressed to 'Y' were returned because it had ceased to exist by the time investigations were carried out. 'Y's bank account was obtained from the Bank, which showed various credits and debits. Debits were for payments made to the assessee from whom cloth bales were purchased by 'Y'. Credits were for sales made by 'Y'. Some of the credits were, therefore, selected and traced to their source. This scrutiny led to traders in the northern part of India removed far away from the assessee's place of business. Letters were addressed to these traders asking them to furnish complete and detailed copies of 'Y's account and assessee's account. Their purchase bills were also called for. These bills contained information regarding bale No. S, and the name of the manufacturing Mill was of the assessee itself. Goods were found dispatched from the assessee's place of business and not of 'Y'. All bills were printed by the assessee's own printers. The serial nos. of the cloth bales appearing in these vouchers and representing goods produced by the assessee were found missing from the assessee's production registers. The circumstantial inference that production was suppressed was established in view of the exact bale numbers that were not accounted for by the assessee company in its books of account. Cheques in respect of sale proceeds of suppressed production were all realised through this non-resident's account. It transpired that, the non-resident 'Y' had no activity whatsoever

except for realising sale proceeds received by cheques. The fraud was conclusively established only as result of tracing some of the well selected credit entries in Y's bank account.

12. INFLATION OF EXPENSES

12.1 Many assessees inflate the expenses in Trading and Manufacturing account by claiming bogus purchases or by over-invoicing of purchases. Similarly, expenses in the profit & loss account are inflated by claiming bogus expenses like commission, payments to contractors, payments for advertisement, etc.

12.2 Illustration (Bogus Purchases): The case for F. Y. 2014–15 of a unit engaged in the manufacturing of the gray cloth was selected for scrutiny. It was noticed that the assessee had shown purchases of yarn from three concerns in September,2014, but the amounts of the purchases were shown as outstanding at the close of the accounting year i.e. on 31-3-15. The AO called for the purchase bills for verification and conducted inquiries on the addresses given on the purchase invoices. No such parties were found on the given addresses. The assessee submitted that the parties supplied the goods at the factory as per the purchase bills and that the payments had subsequently been made through crossed cheques in July, 2015. The AO obtained the bank account statement, which showed that the payments were made through cheques and withdrawn from the account. From this, the cheque numbers and dates of the withdrawal from the bank account were ascertained. It was noticed that these cheques were withdrawn through clearing from the bank. Xerox copies of both sides of these cheques were obtained from the bank, and from these, the bank in which these cheques were deposited, was identified. On verification of the details produced by the clearing bank, it was noticed that all the three bank accounts, where these cheques were deposited, were opened only two days before the depositing of the above cheques, and the amounts deposited were withdrawn by cheques on the very next day, after which the accounts were closed. On verification of the cheque foils by which the amounts were withdrawn from the accounts, it was found that these amounts were again transferred through clearing to another bank account. Verification of these bank account revealed that these accounts were also opened just two days before the depositing of these cheques and that the amounts credited were immediately withdrawn in cash. The account opening forms of the intermediate accounts obtained from the various banks revealed that all the bank accounts were introduced by the family members of the assessee. The pay-in-slips of the amounts deposited in the various bank accounts were obtained, and it was found that these were written in the hand writing of one person only. Same hand writing was noticed on the various cheques drawn from the different banks also.

13. INTRODUCTION OF UNACCOUNTED CASH AS CASH CREDIT

13.1 At times unaccounted cash is brought in the books by the assessee through bogus transactions which are routed through bank to make them look genuine.

13.2 Illustration: During scrutiny of the Balance Sheet of a private limited company, it was noticed that, unsecured loan and share application money of approximately Rs. 50 lacs had been introduced during the year. The assessee produced the acknowledgments of returns of income, Balance Sheets, profit & loss accounts of the persons, in whose names such amounts had been introduced. In most of these, incomes ranging between Rs. 25,000/- to Rs. 35,000/- had been shown, from tuition, sewing, trading of cut piece cloth etc. In the capital account, there was opening capital. The AO was not satisfied about the genuineness of the unsecured loan and share application. He requested the assessee to produce the parties for examination but the assessee said that he had furnished sufficient evidence to prove

the identity, capacity and genuineness of the transaction. On inquiries at the addresses given on the acknowledgements of return of income, it was found that the parties were not in existence at the addresses given. The AO requested the assessee to produce the bank account number, bank branch and the details of the cheques through which the money was received. The assessee submitted that the bank accounts were in the custody of the respective persons and they will not give such financial statements to it. But it furnished the details of the cheque number, date and amount received with the date of clearing in his account. On the basis of the cheque numbers and dates, the bank accounts were identified in the various banks and the bank account statements along with pay-in-slips and cheques exceeding Rs. 50,000/- were obtained. From these, it was found that the accounts were opened in different banks only one day before the cheques were cleared and in all these accounts, cash equivalent to the amount of the cheques issued had been deposited. The pay-in-slips for the cash deposited in different bank accounts and the cheques issued from them were found written in one hand writing.

14. DEBIT ON ACCOUNT OF BANK CHARGES

14.1 Bank charges are collected by banks for various services, e.g. for encashment of upcountry cheques or collection of dividends or for maintenance of safe custody account or for remittances made on behalf of the account holder (the assessee). Therefore, debits for bank charges can be easily co-related to the transaction which should also appear in the bank account. If any entries are found not to relate to transactions in the bank account, the matter should be pursued with the bank to ascertain the exact nature of transactions. For example, if a bank pass book shows remittances, and immediately after or before there is an entry in respect of commission charges for the same, there may not be need for tracing this remittance through the bank because it should find place in assessee's accounts and the AO would be in a position to judge its relevance to the investigation. Scrutiny of these entries may likewise bring to light safe deposit accounts wherein are lodged undeclared shares and securities or may lead to unearthing of secret investments.

14.2 Illustration: An assessee had deposited amounts with up-country branches out of his secreted profits. For this purpose he had remitted sums through head office. Remittances did not find place in the assessee's bank account, as the amounts were paid in cash on the bank's counter. However, bank charges for making these remittances were not paid in cash and were, therefore, found debited in the bank account of the assessee. The amount of charges were too paltry for the assessee or for the banker to bother about, but they provided an important clue. While scrutinising the bank pass book, the commission could not be co-related to a definite transaction. Enquiry with the bank led to discovery of the assessee's deposits with the Bank's upcountry branches. A substantial concealment, was unearthed because of a small slip on the assessee's part.

14.3 Other Similar Clues

i. Interest on secret accounts may have been credited to the current or savings account and withdrawn subsequently.

ii. Commission paid for D.D. or T.T. (not disclosed) may have been debited to (the current) account.

iii. Interest charged on an overdraft arrangement utilised for secret activity may have been debited to the current account.

iv. Banks occasionally also undertake transactions in shares and securities on behalf of their constituents. Entries for transactions in shares undertaken by the bank on behalf of the assessee may bring to light undisclosed business.

14.4 Illustration: During a search, no worthwhile assets were found. A bank pass book, having very few entries was found. However, there was a debit entry, with narration, yourself (y/s). On verification with the bank, it was noticed that the assessee had purchased a Pay Order, favouring another business concern. The books of accounts of the recipient of this Pay Order were examined, which showed receipts of Rs. 9,30,000/- including this Rs. 1 lakh from the assessee. Further inquiries were conducted to trace the origin of the balance amount of Rs. 8.30 lacs. These turned out to be pay orders purchased by debiting several other benami accounts. An analysis of these benami accounts, led to the discovery of 3 flats, and fixed deposits of Rs. 45 lacs owned by the assessee in benami names.

From analysis of bank a/c statement, many a times debit entry of locker charge is found. On the basis of the entry bank locker maintained by the assessee can be traced.

15. TRACING OF SECRET BANK ACCOUNTS

15.1 As said earlier, tracing all accounts with same customer ID and calling for all customer Ids with same address is basic step. It also helps to know the family members names, the associates and top management persons or trusted persons/ accountants names. After getting this information, enquiries are required to be made with selected bank branches. Where secret bank accounts are found, it is necessary to trace important debits and credits. The assessee may be crediting sales suppressed altogether so that the credits may well be wholly his profits. These may have been withdrawn in cash or by bearer cheques encashed by the assessee or someone closely connected with him. However, the presence of credits and debits in the aforesaid manner is likely to give this an appearance of a trading account and if the AO is not vigilant enough to analyse the credits, the assessment may have to be made on the basis of percentage of profit applied to the total credits assuming them to be sales.

15.2 Illustration: In one case, accounts were maintained in a thorough manner. The assessee was an importer of cloth. He showed as if he had entered into agreements long back with a number of well-established existing and genuine firms to whom he was selling at fixed rates. The agreements were suspected to have been entered into later, but were given the appearance of old agreements so that documentary evidence could not be challenged. The market had risen very high, but the assessee was accounting for his sales only at contracted rates with the result that his incidence of tax was substantially reduced. The business was located at 'B'. A study of the correspondence files indicated that the assessee was closely connected with a place 'C'. He used to go frequently to this place as per the details of his travelling expenses. His accounts showed his contacts with the Bank of India and the Central Bank. Letters were, therefore, addressed to these two banks located at 'C' after obtaining the genealogical tree of the assessee and his sons and making out a comprehensive list of persons in whose names bank accounts could be expected. Information from the banks revealed accounts with substantial deposits in the names of the assessee and his family members.

16. REMITTANCES OF SECRET T.T./ D.D. IN BENAMI NAMES

16.1 Remittances out of secret accumulations by T.T. or D.D. in benami names could sometimes be traced to the beneficial owner by following up applications signed by trusted employees or by the assessee himself. TT transfer is always bank to bank and cannot be encashed over the counter. After core banking it is almost discontinued.

16.2 Illustration: In one case, the assessee was a firm dealing in manufacture and sale of coconut oil. Owing to the high incidence of Sales tax in the State during the relevant accounting

year there was a general impression that there had been huge suppression of sales by the producers. The suppression could not easily by detected because even the purchases of Copra were suppressed, due to which the quantitative accounts filed by producers did not show any abnormal shortage or wastage. One particular line of investigation yielded very valuable information. Since the transactions outside the books must have been on a considerable scale, it was anticipated that at least a portion of these would have passed through banks. The party in question would of course never pass these moneys through a current account, but there was the possibility that he might have recovered uncrossed DDs and TTs and cashed them across the counter without any entry in any books except the bank's D.D. And T.T. register. These registers were therefore verified. It was then seen that large amounts sent and received by the assessee firm through various banks had been completely omitted from the books. Substantial turnover was thus found to be concealed.

17. DISCOUNTING OF BILLS

One of the functions of the bank is to discount bills, it is the bill-brokers who generally arrange for big credit facility by getting in touch with persons desirous of borrowing money for short periods. The banks maintain complete record of bills discounted, names of the drawers and the drawees, amounts of bills, due dates, and names of bill-brokers etc. Therefore, if proper particulars are obtained from the banks regarding relevant transactions, there may be useful for testing the correctness of the books of account of the assessee.

18. ANALYSIS OF FOREIGN EXCHANGE TRANSACTIONS

18.1 Verification of last page of the passport would show the foreign currency purchased by the holder. Payments above Rs. 50,000 for purchase of foreign currency has to be made by account payee cheque. An analysis of the transaction relating to foreign currency purchase may reveal accounts outside the books of account.

18.2 Illustration: In a search in the case of a dealer in wood products, no bank accounts or fixed deposits were found, even though there was evidence of suppression in sales. The endorsement on the passport showed purchase of USD 5500 on 3-4-07. The amount debited in the book was Rs. 1,08,750/-, which appeared to be low. The endorsement was done by M/s. TT Travels. A letter was sent to TT Travels, requesting for details of foreign currency purchased. This revealed that the actual amount was Rs. 2,47,375/-, out of which Rs. 1,38,625/- was paid by cheque from an unknown account. From the bank account of TT travels, the details of cheque issued for the above amount was traced. This revealed a bank account with Central Bank of India. This account showed huge remittances which were analysed in detail by obtaining credit slips and tracing their origin. These inquiries revealed 47 different bank accounts opened by the assessee, where he had show-rooms across the country.

19. VERIFICATION OF CREDIT CARD SLIPS

Payments of expenses through credit cards is becoming popular on account of their convenience. Often payments towards credit card balance may be made from undisclosed bank accounts. An analysis of the credit card payments may also reveal undisclosed accounts of the assessee.

20. TAX EVASION USING NETWORKED SYSTEMS OF BANKING

20.1 The investigation of bank account has become difficult as real time transfer of funds and withdrawals of funds has become easy among all the branches of a particular bank, after computerisation and networking.

20.2 Illustration: In the case of an assessee (Jacob Thomas) there was a suspicion that he had an account with IndusInd Bank, as an ATM card of the bank was found with him. Therefore, a letter was sent asking for copy of his account. The bank replied that there was no such account. When the ATM card was mentioned, the bank replied that the name of the account holder is J Thomas. In this account, there was only a credit entry of Rs. 70,000/-. The bank confessed that the assessee did not have any other account with the branch. Thereafter, the source of this credit of Rs. 70,000 was traced, and it was found that, the amount that came to the branch by clearing was Rs. 7,00,000/-, which left the balance of Rs. 6,30,000/- as a mystery. When, the branch manager was questioned, it was revealed that the balance amount of Rs. 6.30 lacs was transferred as fixed deposits of Rs. 70,000/- in 9 accounts, at 9 different branches of IndusInd Bank located at Bombay, Delhi, Calcutta, etc. This transfer was possible using the network system of the branch.

21. Enquiry of STRs: In one case Suspicious Transaction Reports (STR) were received from FIU. The DDIT found 17 bank accounts of different individuals and linked them to 2 addresses pertaining to a big garment manufacturer. A survey was done and the MD admitted that they all are his accounts in the name of his employees. Post survey, the bank statements of all the suspicious accounts were obtained, all the entries in the accounts were tabulated date-wise and matched with the cash book ledger of the company. When this analysis was done, the assesee was not able to explain the entries in respect of cash deposits and withdrawals from those accounts. Peak credit in this case was worked out to Rs. 12 crores when the entries in all the accounts were tabulated into a single ledger and this was accepted by the assessee as his undisclosed income.

22. REAL TIME GROSS SETTLEMENT (RTGS)/ NATIONAL ELECTRONIC FUNDS TRANSFER (NEFT)

RTGS and NEFT are electronic payment systems that allow individuals to transfer funds between banks. Both these systems are maintained by the Reserve Bank of India. It is applicable only for money transfer within the country. These mode of payments are becoming more and more popular than the cheque based transfers.

Under RTGS, the funds transfer takes place on a real time basis i.e. at the time the request is received. It is one of the fastest interbank money transfer facility available through banking channels in India. The beneficiary bank has to credit the recipient's account within 30 minutes of receiving the funds transfer message. On the other hand, NEFT operates on a deferred settlement basis. Fund transfer under NEFT is settled in batches as opposed to the real-time settlement process in RTGS. The batches are settled in hourly time slots.

Each RTGS/ NEFT transaction is assigned a UTR number. The UTR Number is unique for a transaction in the RTGS system. The Unique Transactions Reference (UTR) number is 22 characters length, which can be used for further reference. The structure of the unique number is "XXXXRCYYYYMMDDnnnnnnnn" where XXXX is IFSC (first 4 character) of sending participant, R represents RTGS system, C represents channel of the transaction, YYYYMMDD represents year, month and date of the transaction, nnnnnnnn denotes the sequence number. To verify the money trail, one can use the UTR number to identify source bank account from where such transaction was made. These transactions are also time stamped which can help in identifying the coordinated transfers without actual sale-purchase basis.

CHAPTER

16

Defective, Duplicate, or No Accounts Cases

1. WHERE DOES ONE FIND SUCH CASES?

1.1 There are assessees who do not maintain regular account books but estimate their profits as a percentage of their turnover/ sales. e.g. contractors, professionals like doctors and lawyers. But most often we find cases of informal accounts, incomplete accounts or duplicate accounts during the course of searches/ surveys. One may find:

- Details of unaccounted investments.
- Unaccounted sales/ turnover.
- Unaccounted purchases of raw materials, production of goods and sales of the same
- Unaccounted money-lending business.
- Statement of physical verification of stocks which on comparison with books of account shows excess stock/ deficit stock.
- Duplicate set of books which on comparison with the regular books of account shows that sales/ revenue are suppressed or expenses are inflated.

The list burgeons as the ingenuity of the tax evader is bountiful. Generally the information made available as a result of search/ survey in the form of seized materials would be a combination of two or more of the items mentioned above.

Where books and records are incomplete or unreliable, because of the inadequacy or even complete absence of records, it is often not possible to construct revised accounts on conventional lines. For such cases, the assessments generally have to be based on indirect methods. Indirect methods are founded on an investigation of the taxpayer's personal affairs. There is no single "best" indirect method of quantification; the method used depends on the circumstances of the case.

2. COMPUTATION OF PROFIT IN NO ACCOUNT CASES

In cases where accounts are maintained on the basis of double entry book keeping, the profit for an accounting period can be ascertained by the preparation of a trial balance, P&L a/c. and a Balance Sheet.

Where there are no accounts or accounts are incomplete, it is not possible to prepare trial balance, P&L a/c. and Balance Sheet. In such cases the profit can be arrived at by one of the following methods:

- Increase in capital or investment method
- Estimation of profit or income method
- Cash flow and investment method
- Peak credit method

3. INVESTMENT METHOD OR INCREASE IN CAPITAL METHOD

3.1 In a case where proper books of account are not maintained, profit can be ascertained by comparing the capital at the end of accounting period with that at the beginning of the accounting period. Capital at any time = Assets (-) Liabilities.

3.2 It is possible to find out the capital by preparing a «statement of affairs». A statement of assets and liabilities prepared in cases where books of accounts are not maintained under the double entry system is called a ‹statement of affairs›.

3.3 Prepare a statement of affairs as at the beginning of the accounting period. List out all the assets and liabilities as at the beginning of the accounting period. By utilising the formula, Capital = Assets (-) Liabilities, the capital as at the beginning of the accounting period, can be ascertained. Similarly, a statement of affairs as at the end of the accounting period is prepared and the capital at the end of the accounting period, is ascertained.

Closing Capital (-) Opening Capital = Increase in capital

3.4 Illustration

Statement of Affairs of Mr. ABC as at 31.3.2017

Liabilities		Assets	
Loans from A	2,00,000	Advance Tax	17,750
Loan from B	1,25,193	LIP	3,308
Security deposit from employees	52,000	PPF	1,000
Capital		Furniture and Fixtures	24,000
(being the difference between assets and liabilities)	3,99,519	Investment in shares	59,288
		Closing stock	80,000
		Sundry debtors	3,12,327
		Remittance to chit funds	52,122
		Purchase of land	1,96,477
		Cash in hand	6,000
		Closing balance in bank accounts	24,440
	7,76,712		7,76,712

Statement of Affairs of Mr. A.B.C. as at 31.3.2018

Liabilities		Assets	
Loans from A	2,00,000	Advance Tax	22,955
Sundry trade creditors	1,25,193	LIP	6,616
Security deposit from employees	72,000	PPF	3,000
HDFC Loan	3,76,000	Furniture and Fixtures	24,000
Capital (being balancing figure)	11,59,043	Investment in shares	1,59,288
		Closing stock	80,000
		Sundry debtors	2,41,792
		Investment in flat	4,90,000
		Investment in residential bldg. & land	8,50,000
		Closing balance of bank accounts	49,585
		Cash in hand	5,000
	19,32,236		19,32,236

Capital as on 31.3.18	Rs. 11,59,043
Capital as on 31.3.17	Rs. 3,99,519
Increase in capital	Rs. 7,59,524

The following adjustments to the increase in capital are required to arrive at the profit from the business:

- Add drawings for personal/ household expenses.
- Deduct fresh capital introduced from other sources e.g. Agricultural income/ sale of shares/ investments.
- Add interest paid for loans taken for purposes other than business purposes, e. g. where, an assessee purchases a house-plot out of loans taken from bank, the interest paid on such loan is to be added.

Therefore, following adjustments may be made to the increase in capital worked out above -

Increase in Capital	**Rs. 7,59,524**
Add: Drawings @ Rs. 10,000 p.m. (10,000 x 12)	Rs. 1,20,000
Add: Interest on loans taken for purchase of house plot	Rs. 20,000
	Rs. 8,99,524
Less: Agricultural income from ancestral land.	
The assessee's claim considered as genuine and reasonable	Rs. 40,000
Income from Business	Rs. 8,59,524

3.5 To sum up, for determination of income when no books maintained or books are incomplete, then the AO must call for the following documents:

- Bank accounts in the name of assessee/ family members/ joint accounts operated by the assessee–in India and in foreign countries, KYC for such accounts - along with explanations for all debit and credit entries;
- Credit card statements and source of payment thereof;
- Depository account statements;
- Investment in immovable and movable properties–land/ plots, farm house, flats/ buildings, shares, bonds, mutual funds, cars, jewellery, life insurance policies, FDs, PPF etc. in the name of assessee or family members or benamidar, if any;
- Expenditure in maintaining opulent lifestyle - club memberships, mall/ shop membership card and their reward programs, foreign tours (information can be obtained from passport/ credit card payment);
- GST/ VAT returns;
- TDS certificates;
- Details of loans, gifts taken and given;
- Confirmations from sundry creditors and persons who have given loans or gifts;
- Information from Public Sources and Other Government Agencies.##

##One may refer to http://pubdocs.worldbank.org/en/ 220301427730119930/AML-Module-4.pdf–an article on investigation techniques and Information from Public Sources and Other Government Agencies.

- Bank account statement includes not only account details and transaction details, but also identifying physical locations where transactions took place, such as at an automated teller machine (ATM) where a deposit/ withdrawal was made.
- All the credits in bank accounts to be treated as income other than loans, if genuineness, identity and source of income of creditors is explained.
- Unexplained investments/ expenditures to be treated as income.
- Sales/ income reflected in GST/ VAT returns, TDS certificates to be added to income if not reflected in bank statements.

- It's a common practice to invest in the name of spouse or children. Any money received from a spouse is tax-free, but if it is invested, the income from that investment is added to the income of the giver and taxed accordingly. So, if assessee bought a house in spouse's name, any income from that house, whether as capital gains when he/ she sells it, or as rent, will be treated as his/ her income. If spouse did not contribute any funds for buying the house, he/ she will be taxed for the entire income. If assessee has invested in fixed deposits in the name of his/ her spouse, the interest earned will be treated as his/ her income.
- In case of income from business, if cash sale memos/ bills were found for a particular period, cash sale for the entire period may be estimated.
- Details such as ledger accounts may be called from debtors/ creditors to ascertain the amount of income and expenses and if any discrepancy is found, the difference may be added as unexplained income or investment

Documents and other leads will need to be gathered from a range of sources, including the Internet and other publicly available sources; government agencies; financial institutions including e-banking; money service providers; law and accounting firms; trust and company service providers; real estate agents; art dealers; business competitors; travel and other reward programs; businesses, relatives, employees and associates of the targets; and the targets themselves.

4. CASH FLOW AND INVESTMENT

4.1 The method of arriving at the profit from business by following the 'increase in capital method' is suitable for cases where no accounts are maintained. But it also becomes relevant in cases where though accounts are maintained, unaccounted investments are found out as a result of search or survey. Obviously, the source for making such investment is the unaccounted business income of the assessee. Quite often the evidence relating to such unaccounted business transactions would be patchy or too thin, i.e. evidence may be available for a part of the accounting year or evidence available may not give a clear picture of the entire unaccounted business transactions. If the evidence available regarding suppression of income is weak or relates to only a part of the accounting period, estimating the business income for the entire accounting period on the basis of such weak evidence is not advisable. It would be better to complete the assessment on investment method taking into consideration the unaccounted investments made by the assessee. However, the AO may mention whatever evidence is available regarding the suppression of business income in the assessment order and point out that though the evidence available strongly indicate suppression of business income, such income is not estimated since the evidence for the entire accounting period is not available and that the concealed income is assessed on investment method.

For example, in the case of a jewellery firm, the search revealed that most of the sales and purchases were not recorded in the books of account. Each sale was effected by preparation of an "estimate" in a sheet of paper and at the end of the day, such pieces of paper were fed into the paper shredder. The search party could get hold of a few pieces of such paper. Estimating the total suppressed sales and the G.P. thereon on the basis of such thin evidence would not be reasonable. Hence the assessment had to be completed taking into account the unaccounted investments.

4.2 Even in cases where regular books of account are maintained, when unaccounted investments are found out, the assessees make valiant efforts to give explanation regarding the sources for making such unaccounted investments. Quite often, they prepare a cash

flow statement for the unaccounted transaction. A cash flow statement has an outflow side and an inflow side. On the outflow side are depicted the unaccounted investments and unaccounted expenses. The sources (unaccounted) for making such investments are written on the inflow side. The deficit i.e. the difference between the total of the outflow side and the total of the sources written on the inflow side is offered as income.

5. ESTIMATION OF PROFIT METHOD

5.1 In cases where the accounts are incomplete and information is available regarding sources of income, i.e. sales/ amount lent on interest/ receipt by way of professional income/ contract receipts but information regarding investments are very little, the method of estimating the income as a percentage of the turnover may be adopted. The method of estimating the profit would vary depending on the facts of the case and information available.

5.2 Where Entire Unaccounted Sales are Treated as Income: Where the entire purchases and other expenses are accounted but a certain portion of sales alone are unaccounted, the entire amount of such unaccounted sales are to be treated as the income of the applicant as the corresponding expenses have already been debited to the P&L Account.

5.2.1 Where Gross Profit is Estimated: Very often a part of the business transactions are not recorded in the regular books of account. For example, it was found in the case of a beedi manufacturer that though he maintained regular books of account, a certain portion of the purchases of raw materials such as, beedi leaves, production of beedi out of such purchases and sale of such beedis were not recorded in the regular books. Investigations revealed that such unaccounted beedis were sent to the distributors for sale not through the regular transporter, but through a different transporting agency. Therefore, the quantum of unaccounted sales could be ascertained from the transporting agency. The entire unaccounted sales cannot be treated as the income of the assessee because verification revealed that the corresponding purchases of raw materials and manufacturing expenses were also unrecorded. The entire unaccounted purchases during the accounting year cannot be treated as the unaccounted/ unexplained investment of the applicant as the applicant would not buy the total quantity of raw materials at a time and then process it and sell it. He needs to make unaccounted investments (in the purchase of raw materials and manufacturing expenses) for one or two or three months› unaccounted production. He would be able to sell such unaccounted production and the unaccounted sale proceeds could be utilised for further unaccounted production and sales. Therefore, in cases such as these, the G.P. on the unaccounted sales and unaccounted circulating capital have to be assessed as the income. The G.P percentage. may be determined on the basis of the G.P percentage on the accounted sales as well as in comparable cases.

5.2.2 There is no fixed formula for working out the circulating capital required to effect the unaccounted sales. Depending on the nature of the commodity dealt with, the demand for the commodity at the relevant time, one has to make a reasonable estimate of the unaccounted circulating capital. One factor which can be taken into account while estimating the unaccounted circulating capital is the ratio of 'stock to turnover'. The turnover divided by the closing stock gives a rough idea of how many times the stock-at-hand is rolled over. Take, for example, that the accounts of an assessee show the following figures:

Turnover	Rs. 4,00,00,000
Closing Stock	Rs. 80,00,000
Stock turnover	Rs. 4,00,00,000 = 5times
	80,00,000.

The stock is rolled over five times. It is only a rough estimate in the sense that the figure of closing stock need not be the figure of stock-at-

hand at any point of time. Now suppose in this case, unaccounted purchases and sales were found out and the unaccounted sales amounted to Rs. 90,00,000. Applying the same "stock turn over ratio", it could be presumed that to achieve a turn over of Rs. 90,00,000, the assessee required stock-in-hand of Rs. 90,00,000/ 5= Rs. 18,00,000. This could be considered as an indicator of the circulating capital required. The AO should also take into consideration other factors (such as whether goods are available on credit, and also the fact that the "stock-turn over ratio" as per the accounts itself gives a rough picture) while estimating the unaccounted circulating capital.

5.3.1 Where Net Profit is Estimated: Where no books of account are maintained, but sales figures are available or where books are rejected, the net profit may be estimated. In some cases, the AO may find it extremely difficult to estimate the net profit as in the following example.

Illustration: In the case of a private limited company engaged in the manufacture of chloroform from alcohol, the seized record showed that everything was apparently all right. The company purchased rectified spirit from distilleries. The purchase of rectified spirit was regulated by the state excise department and the assessee could buy rectified spirit as per the quota allotted to it by the state government. The purchase price of rectified spirit was also fixed by the state excise department. The assessee was required by law to maintain a stock register of rectified spirit purchased and a stock book for the chloroform manufactured out of the rectified spirit so purchased. Both the stock registers were regularly inspected by the officials of the state excise department and their stamps were affixed. However, in order to verify whether there was inflation in the purchase of other raw materials, enquiries were conducted regarding the purchase of other raw materials such as, sulphuric acid, coal etc. Surprisingly, it was found that very little quantity of other raw materials were actually purchased though account books showed that bigger quantities were purchased. It was apparent that with the small quantity of sulphuric acid and other raw materials purchased, the assessee could not have manufactured the quantity of chloroform as shown in the records. Therefore, a doubt arose whether the assessee actually produced the quantity of chloroform as recorded in the books. On verification of the sales, it was found that most of the sales were bogus. On scrutiny of the bank account of the assessee, it was found that the demand drafts credited into the bank account which were supposed to have been received from far away places of the country were not actually demand drafts, but bankers cheques issued locally. On further verification, it was found that the bankers cheques were purchased by remitting cash. Therefore, the conclusion was that the assessee did not actually manufacture chloroform, but sold the rectified spirit in the black market and made huge profits. On the basis of the above findings, the books of the assessee were rejected as incomplete and unreliable. However, the difficult task was to estimate the net profit on the sale of alcohol in the black market. There was no evidence regarding the black market price of rectified spirit. Therefore, the net profit was estimated in an indirect way. From the government owned blending unit (units where rectified spirit was converted into arrack by adding water), the quantity of arrack that could be produced from one litre of rectified spirit was found out. The sale price of one litre of arrack could be found out from the assessment records of arrack dealers. Thus, the quantity of arrack that could be manufactured out of the quantity of rectified spirit was found out. The sale price of so much quantity of arrack could be also worked out. The difference between the purchase price of rectified spirit and the sale price of the arrack that could have been manufactured out of the rectified spirit was worked out. Since the assessee was not himself converting the rectified spirit into arrack and selling it, the entire profit could not be attributed to him. Taking into consideration the expenditure involved in doing such an illegal

business and also the profit of the blender and dealer who purchased the rectified spirit, the Net Profit of the assessee was estimated. On appeal, though the CIT(A) and Tribunal reduced the percentage of net profit, the method adopted was upheld.

6. PEAK CREDIT AS AN ALTERNATIVE TO ESTIMATION OF INCOME

6.1 Sometimes, an assessee may conduct his unaccounted transactions through one or more bank accounts or may record such transactions in a vague manner in one or more books. The deposits in such bank accounts may reflect:

- Unaccounted sales.
- Unaccounted cash introduced.
- Unaccounted loan received from others.
- Unaccounted loans returned by others.
- Unaccounted sale proceeds of investments such as shares, properties.

Details may not be available to segregate the deposits into the above heads and quantify the total amount under each of the above heads. Estimating the profit as a percentage of the total of the deposits would be incorrect. In such cases, working out the peak credits (receipts) or the debits (Payment) may give an indication of the total unaccounted money in the possession of the assessee which may be assessed as his income.

6.2 Illustration: It was found that an assessee opened 8 bank accounts in the name of non-existing persons in a Co-operative bank and unaccounted transactions in shares were done through these bank accounts. There were innumerable transactions in these bank accounts. On examination, it was found that the assessee applied for shares in the names of different non-existing benami persons. Similarly, he also purchased shares in the secondary market and sold them. Since no regular books of account were maintained, it was very difficult to understand each and every entry in the bank accounts such as, whether they relate to cash introduced, refunds received, sale proceeds received, etc. In an ideal situation, the following should be considered in the assessment:

- Unaccounted cash introduced to purchase shares in the primary market.
- Profit on the sale of shares allotted.
- Unaccounted cash introduced in the purchase of shares in the secondary market.
- Profit on the sale of shares purchased in the secondary market.
- Dividends received from the shares.

In this case, since no primary records were maintained regarding each and every transactions, it was practically impossible to analyse the bank transactions into the above mentioned headings. It may be noted that in this case, estimation of profit on the total turn over is not possible, because, the deposits in the bank accounts consist of cash deposited (unaccounted money introduced), refunds received when the shares were not allotted, sale proceeds of the shares and dividends. The computation of profit on the purchase and sale of shares requires definite information regarding the shares purchased and their cost of acquisition, and information regarding the sale of each and every share. Getting such information was practically impossible. Estimation of profit on the total sale proceeds is not applicable in this case, as the profit earned from the sale of shares from different companies would vary widely. Hence, the only practical way of ascertaining the total income was to follow the peak credit method. It was thought that the peak amount in the 8 bank accounts would give an indication of the total money invested and income earned thereon. An attempt was made to prepare a peak credit statement of the 8 bank accounts combined. The peak amount was found out at Rs. 69,45,995. The assessee also had to agree to the above mentioned figure.

7. PREPARATION OF PEAK CREDIT STATEMENTS

7.1 Peak credit statement can be prepared only if records for the receipt and payment of money for the entire accounting period are kept. The records need not be regular books of account maintained under double entry system. Even a rough account where dates of receipt and payment of money are recorded would suffice. For example: where an assessee maintained undisclosed bank accounts, from the bank account statements, peak credit or the peak of the amounts deposited can be worked out. But if the records are incomplete or if the records available only show total amount received on a particular date, a peak credit statement cannot be prepared. For example, in the case of an assessee who was engaged in the business of processing of sea food, a document was seized in which the amounts advanced to boat-owners as on a particular date (say 61, 291) was recorded. The amount advanced as recorded in the seized material was Rs. 28,72,392. It was quite possible that the assessee had been advancing money to the boat owners periodically and adjusting the purchases from them against such advances. It was also quite possible that the peak of the amount advanced might have been more than Rs. 28,72,392. But in the absence of the running accounts of the boat owners, it was not possible to prepare a statement of peak advances. Since the assessee did not maintain regular books of account, the assessment could be completed only under the investment method taking into account investments including the advances.

7.2 The following aspects should be borne in mind while preparing a peak credit statement -

- it should be chronological
- only one statement should be prepared even when credits appear in more than one book. e.g. If 5 unaccounted bank accounts of an assessee are found out, one consolidated peak credit statement should be prepared chronologically.
- if peak credit statement is prepared for more than one accounting year, the "incremental peak credit only should be assessed" for the relevant asst. year.

7.3 Illustration

Accounting year	Peak of the Accounting Year	Amount to be Assessed Sincremental Peak Credit
2013–14	12 lakhs	12 lakhs
2014–15	15 lakhs	3 lakhs (15–12)
2015–16	14 lakhs	Nil
2016–17	22 lakhs	7 lakhs (22–15)
Total		22 lakhs

The peak credit of Rs. 22 lakhs appears in accounting year 2016–17 but the incremental peak credit should be assessed as shown above.

7.4 'Peak credit' may not always indicate the total unaccounted money of an assessee in circulation. In the case of an assessee engaged in the business of illicit trade in arrack, the arrack was sold to a party at a distant place and the sale proceeds were remitted by TT into a fictitious bank account. The bank account was found out during the course of search. The bank account revealed that the total amount remitted into this bank account was about Rs. 1.5 crores. The amounts remitted into the bank account were immediately withdrawn by cash. Therefore, the peak credit in this bank account was only about Rs. 5 lakhs. It may be seen that assessing the peak credit as the income in such a case is totally unrealistic. The net profit on the turnover is to be estimated and assessed. In addition to that, the circulating capital (or initial unaccounted investment) is also to be estimated and assessed.

8. ESTIMATE OF INCOME OR PEAK CREDIT

8.1 There are cases where it would be possible to arrive at the income by both the methods i.e.

by estimating the G.P. or N.P. or arriving at the income by way of peak credit method. The AO should study the facts and circumstances of the case and select the method which is most suited to the facts and circumstances of the case.

8.2 Illustration: The assessee, a dealer of industrial scrap maintained accounts regularly. Losses were disclosed as follows:

Assessment Year	Income/ Loss Returned
2009–10	(-) Rs. 7,10,556
2010–11	(-) Rs. 92,994
2011–12	(-) Rs. 4,88,249
2012–13	(-) Rs. 1,33,140
2013–14	(-) Rs. 64,330
2014–15	(-) Rs. 1,58,080
2015–16	(-) Rs. 1,140
2016–17	(-) Rs. 66,900
2017–18	(-) Rs. 94,511
2018–19	(-) Rs. 90,000

On the other hand, it was found that the assessee purchased a plot of land in a prime location in the city and constructed a very big hotel. In the business of purchase and sale of scrap, the purchase price and the quantity purchased are mostly accounted as the purchases are from big companies. However, there could be much suppression of sale proceeds as there is no standard sale price for scrap. An analysis of the accounts gave the following figures:

From the above analysis, it may be seen that the disclosed gross profit rates ranged from 1.3 per cent to 9.6 per cent. But the net result was loss for all the assessment years except the last one. It was obvious that the assessee had suppressed its income. The unaccounted profit was introduced in the form of bogus credits in the books. The AO had the option to arrive at the concealed income by estimating the G.P. at a higher percentage. But such an action would not stand test of appeal for the simple reason that there were no comparable cases which showed a better G.P. It is quite possible that the assessee might have suppressed his sales. In the absence of any evidence regarding suppression of sales, it was not possible to estimate the sales suppressed and the G.P. thereon. On the other hand, enquiries regarding the creditors proved that they were bogus. Therefore, arriving at the peak credit was considered to be the best method of arriving at the concealed income. Peak credit was worked out by preparation of an elaborate statement. Actually, there were 163 creditors. The results of the working of the peak credit and the incremental credit to be assessed each year were as under:

Asst. Year	Scrap Sales	Gross Profit	% of G.P.	Interest Debited in P/L Account	Net Profit/ Loss
2009–10	11,104,250	985,269	8.87	1,557,848	(-) 7,93,436
2010–11	10,194,816	986,848	9.68	961,472	(-) 1,15,894
2011–12	6,580,826	516,666	7.85	918,706	(-) 5,35,950
2012–13	2,690,902	168,783	6.27	236,699	(-) 1,43,902
2013–14	3,824,967	323,129	8.39	254,467	(-) 75,219
2014–15	13,257,281	385,808	2.91	324,248	(-) 1,69,823
2015–16	30,343,863	395,271	1.3	404,708	(-) 34,545
2016–17	29,716,918	713,360	2.4	379,173	(-) 1,31,235
2017–18	12,965,996	632,788	4.88	357,560	(-) 2,19,313
2018–19	19,088,364	1,670,026	8.75	269,074	(+) 4,36,182

Assessment Year	Peak Credit	Incremental Peak Credit
2009–10	Rs. 4,29,253	Rs. 4,29,253
2010–11	Rs. 3,14,080	--
2011–12	Rs. 2,84,636	--
2012–13	Rs. 4,74,268	Rs. 45,015
2013–14	Rs. 12,65,579	Rs. 7,91,311
2014–15	Rs. 19,71,079	Rs. 7,05,500
2015–16	Rs. 48,10,101	Rs. 28,39,022
2016–17	Rs. 1,24,89,785	Rs. 76,79,684
2017–18	Rs. 1,30,81,750	Rs. 5,91,965
2018–19	Rs. 1,36,04,731	Rs. 5,22,981

9. REPAYMENT OF PEAK CREDIT-SET OFF AGAINST OTHER INVESTMENTS

9.1 Whether repayment of credits after the date of peak credit would be available as source to make other investments? Peak credit is always referable to a date. Consider the following example where there were 1 creditors whose accounts showed both receipts (Cr.) and repayments (Dr.) of various amounts. The accounts were found to be bogus and the assessee agreed to offer the peak credit as income. The peak credit was worked out as below:

Date	A/c. No. I		A/c. No. 2		A/c. No. 3		A/c. No. 4		Net Credits
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	
		O.B.							
1.4.15		25,000	-	-	-	30,000	-	50,000	1,05,000
30.4.15			20,000			5,000			1,20,000
5.5.15	10,000	-	-	-	-	-	-	-	1,10,000
8.5.15	-	-	-	35,000	-	-	-		1,45,000
6.6.15	-	-	-	-	15,000	-	-	-	1,30,000
12.8.15	-	20,000	-	-	-	-	-	-	1,50,000
14.8.15	-	-	10,000	-	-	-	-	-	1,40,000
30.9.15	-	-	-	-	-	50,000	-	-	1,90,000
15.10.15	-	20,000	-	-	-	-	-	-	2,10,000
28.10.15	-	-	-	15,000	-	-	-	-	2,25,000
6.11.15	-	-	-	-	-	18,000	-	-	2,43,000
30.11.15	-	-	-	-	-	-	-	15,000	2,58,000
1.12.15	-	-	-	-	-	-	-	12,000	2,70,000
6.12.15	-	30,000	-	-	-	-	-	-	3,00,000
14.12.15	-	-	-	20,000	-	-	-	-	3,20,000
16.12.15	-	-	-	-	-	30,000	-	-	3,50,000
17.12.15	-	-	-	40,000	-	-	-	-	3,90,000
19.12.15	-	-	-	-	-	-	-	40,000	4,30,000
									Peak Credit
30.12.15	10,000	-	-	-	-	-	-	-	4,20,000
3.1.16	-	-	-	-	40,000	-	-	-	3,80,000
15.1.16	-	-	-	-	-	-	30,000	-	3,50,000
30.1.16	-	-	-	-	-	-	-	10,000	3,60,000
20.2.16	-	-	-	20,000	-	-	-	-	3,80,000
31.3.16	-	-	20,000	-	-	-	30,000	-	3,30,000
Balance		75,000		1,20,000		73,000			62,000

The peak credit of Rs. 4,30,000 as on 19.12.15 was assessed to tax. The assessee made unaccounted purchase of a car for Rs. 5 lakhs on 31.3.16. He claimed that since he had offered additional income of Rs. 4,30,000 (being the peak credit), this amount should be set off against the cost of the unaccounted car and that the addition towards unexplained investment in the car should be only Rs. 70,000 (5,00,000 - 4,30,000). Can the claim of the assessee be accepted? The answer is No. Though the peak credit (Rs. 4,30,000) has been assessed, the money is still in the books of account to the extent of the balance in the account as on 31.3.16 (Rs. 3,30,000). The peak is as on 17.12.15. It is quite possible that the withdrawals subsequent to 17.12.15 could have been utilised for the purchase of car. But there are also deposits subsequent to 17.12.15. It is to be presumed that the deposits subsequent to 17.12.15 were made out of the withdrawals. In other words, the money that could be considered as available to the assessee out of the peak credit, to purchase the car is: Total withdrawals subsequent to the date of peak (-) deposits subsequent to the date of peak.

In effect, this would work out to - amount of peak credit (-) the balances in the accounts of the creditors as on the last day of the accounting year, i.e., Rs. 4,30,000–3,30,000 = Rs. 1,00,000.

Therefore, the assessee can be given the benefit of Rs. 1,00,000 while considering the unexplained investment in the car and Rs. 4,00,000 (5,00,000–1,00,000) should be assessed as unexplained investment in the car. Needless to say that the peak credit of Rs. 4,30,000 should also be assessed.

10. CAUTION

An important point to be borne in mind while assessing peak credit is, its effect on the subsequent assessment years. For example, suppose in a case the search or enquiries revealed that there were bogus credits in the books of the assessee for the assessment years, say, 1994–95, 1995–96 and 1996–97. The peak credits were assessed in the assessment order for these assessment years completed, say, on 30.3.99. Assume that the assessee agreed to such addition of peak credit. In the meantime, the returns for the assessment years 1997–98 and 1998–99 also would have been furnished. In the books of the assessee, the assessee also would have continued these credits and in the Balance Sheets as on 31.3.97 and 31.3.98, at least some of these credits would appear. It is not advisable to ignore such credits for the subsequent assessment years on the assumption that the peak of such credits has already been assessed. It is necessary to re-work the peak credits by taking into account the transactions in the subsequent years also. If there is an increase in the peak credits in the subsequent years, the same could be brought to tax.

11. DOUBLE ADDITIONS TO BE AVOIDED: THE INVESTMENT AND THE SOURCE

11.1 In a case of incomplete account, the AO decides to estimate the income. The AO has also information regarding unaccounted investments made by the assessee during the same accounting year. Before completing the assessment, the AO should compute the income by 'the method of estimating the income'. He should thereafter find out the total of the unaccounted investments and unaccounted expenditures made by the assessee during the same accounting year. If the income estimated is more than the total of the unaccounted investment and unaccounted expenditures, there is no need to make a separate addition towards the unexplained investments and expenditures. If on the other hand, the total of unaccounted

investments and expenditures exceed the income estimated, the assessment should be completed on the investment method without making any addition by estimating the income.

11.2 Illustration: Suppose in a case the profit from unaccounted sales is estimated at Rs. 35 lakhs and the unaccounted investment and expenses are determined at only Rs. 25 lakhs. Do not say that unless the assessee proves that the source for the investment is the income from unaccounted sales, set off can not be given. Remember both the transactions are unaccounted. Being reasonable is the surest way to succeed in appeals.

CHAPTER

17

Cash Credits

1. INTRODUCTION

1.1 Any sum found credited in the books of the taxpayer, for which he offers no explanation about the nature and source thereof or the tax authorities are not satisfied by the explanation offered by the taxpayer, is termed as cash credit.

1.2 No businessman likes to keep his money idle. He desires to invest the money in the disclosed business or in other productive ways and earn more profits. Therefore, the concealed income earned from the sources not disclosed to the revenue is introduced in the books of account of disclosed business as cash credits.

1.3 Unaccounted cash and income of the businessman is generally brought back in his real business concern in the form of loan, share application, deposits or advance. In addition to above, receipt of gifts may be claimed in the individual capacity. Sometimes, other innovative methods may be adopted. The methods adopted to bring back the unaccounted income secretly into the business have become more complex over times. Hence, the Assessing Officer should conduct in-depth investigation and enquiries before making any addition on account of unexplained cash credit.

2. BASIC PROVISIONS

2.1 Section 68 of the income-tax Act, 1961 contains provisions relating to tax treatment of cash credit which is as under:

"Cash Credits

68. Where any sum is found credited in the books of an assessee maintained for any previous year, and the assessee offers no explanation about the nature and source thereof or the explanation offered by him is not, in the opinion of the Assessing Officer, satisfactory, the sum so credited maybe charged to income-tax as the income of the assessee of that previous year:

Provided that where the assessee is a company (not being a company in which the public are substantially interested), and the sum so credited consists of share application money, share capital, share premium or any such amount by whatever name called, any explanation offered by such assessee-company shall be deemed to be not satisfactory, unless:

(a)	*the person, being a resident in whose name such credit is recorded in the books of such company also offers an explanation about the nature and source of such sum so credited; and*
(b)	*such explanation in the opinion of the Assessing Officer aforesaid has been found to be satisfactory:*

Provided Further that nothing contained in the first proviso shall apply if the person, in whose name the sum referred to therein is recorded, is a venture capital fund or a venture capital company as referred to in Clause *(23FB) of Section 10."*

2.2 Section 68 has been introduced in the income-tax Act, 1961 w.e.f. 1.4.1962. In the 1922 Act, there was no provision corresponding to Section 68. The principle of Section 68 is a statutory recognition of what was always understood to be the law based upon the rules of evidence that it is for the taxpayer to prove the genuineness of the borrowings or other credits in his books, since the relevant facts are exclusively within his knowledge. To conclude, Section 68 incorporates only a rule of evidence, placing the onus of proof on the assessee. The onus is on the assessee to prove that the 'credit' in his account is a genuine transaction.

2.3 There have been hardly any amendments in this Section since its introduction. *The major amendment was by the Finance Act, 2012 which introduced the two provisos to this Section.*

3. CONDITIONS TO BE SATISFIED FOR APPLICABILITY OF SECTION 68

3.1 From the reading of Section 68, following conditions can be stated to attract the applicability of Section 68:

a. Assessee has maintained 'books'

b. There has to be credit of amounts in the books maintained by the taxpayer of a sum during the year.

c. The taxpayer offers no explanation about the nature and source of such credit found in the books or the explanation offered by the taxpayer in the opinion of the Assessing Officer is not satisfactory.

If all the above conditions exist, sum so credited may be charged to tax as income of the taxpayer of that year.

4. TAX RATES APPLICABLE TO AMOUNT CHARGED TO TAX BY VIRTUE OF SECTION 68

4.1 As per Section 115BBE, income-tax shall be calculated at 60% where total income of assessee includes following income:

a. Income referred to in Section 68, Section 69, Section 69A, Section 69B, Section 69C or Section 69D and reflected in the return of income furnished under Section 139; or

b. Which is determined by the Assessing Officer and includes income referred to in Section 68, Section 69, Section 69A, Section 69B, Section 69C or Section 69D, if such income is not covered under Clause (a).

4.2 Such tax rate of 60% will be further increased by 25% surcharge, 6% penalty, i.e. the final tax rate comes out to be 83.25% (including cess). Provided that such 6% penalty shall not be levied when the income under Section 68 has been included in the return of income and tax has been paid on or before the end of relevant previous year.

4.3 As per Section 115BBE, the taxpayer is not entitled to claim any deduction, set -off any loss or to adjust the basic exemption limit against the income referred to in Clause (a) of sub-Section (1) of Section 115BBE.

5. CASH CREDITS: DEVICE TO INTRODUCE UNACCOUNTED CASH FOR SHORT PERIOD

Several types of manipulations are resorted to by the assessees to introduce the concealed income in the books temporarily. Some of them are as under:

5.1 Squaring up the Account During the Year: Some of the assessees credit the cash in ingeniously assumed names and square up the personal accounts in question before the close of the accounting year, so that no suspicious of tell-tale credit balance was reflected in the Balance Sheet. The AO had to turn over the pages of the ledger to get at them. As only the balances at the year end are generally compared, the chances of tracing the cash credits become meagre.

5.2 Without Ledgerisation: Some of the assessees enter the credits in bogus names in the cash book to meet urgent business requirements, but avoid their ledgerisation. The cash is withdrawn, without ledgerisation again, when sufficient cash balance is available. The AO cannot find out these credits by turning over the pages of the ledger. He has to scrutinize the Cash book to dig them out. A trained eye may succeed in spotting the credits in the Cash Book which do not bear the ledger page-number or the varying marks used by the assessee to distinguish them from the other normal entries in the Cash Book.

5.3 In the Name of Existing Parties: Some of the tougher assessees attempt to create an ocular illusion by inserting the credit in a personal account which is otherwise true; it may be a Bank account, if it has a large volume of transactions: it may be the account of some other well-known party.

5.4 Ante-dating Sales and Other Receipts or, Alternatively, Showing Secreted Income as Advances Received Against Later Sales: When cash is needed immediately, fictitious cash sales of the stock-in-hand are shown. The sales may actually take place from time to time later. Meanwhile, secret funds are used under cover of the ante-dated sales. These funds are withdrawn by suppressing the later and real cash sales.

5.5 Post-dated Purchases and Expenses: Urgent expenditure is met from secret funds but the debit is entered in the books on a later date when the cash balance makes it possible. The secret funds are replenished on the date of the debit in the books.

5.6 Showing Cash Purchases as Credit Purchases: Purchase of raw material or stock-in-trade is made with secret cash but the purchases are recorded on later dates when disclosed cash balance is adequate.

5.7 Post-dating Withdrawals and Ante-Dating Receipts in Bank Account: A cheque is prepared on the bank and the account of the bank in the assessee's books is credited when there is pressing need for cash. The money is not, however, actually drawn from the bank as the balance in the bank may be required for meeting other obligations. It may be drawn, say, a few days later when bank balance is at a safe level. During the period intervening between the date of the cheque and the date of its collection, concealed money is used under the screen of the credit to the bank's account in the assessee's ledger. The money goes back to the secret cash when the cheque is presented to the bank and the bank pays the cash. The concealed money will not be caught unless that dates of the credits in the bank's account in the assessee's ledger are verified with the dates of the debits in the pass-book issued by the bank.

5.8 Postponing Entry of Cash Deposited in the Bank: The assessee may deposit his secret cash in bank but debit the bank's account later when sufficient cash becomes available in the books.

5.9 Omitting Entry of Cash Deposited in Bank: The assessee may deposit his secret

cash in bank and later withdraw the amount when bank balance becomes adequate without entering the deposit as well as withdrawal in the bank's account in the books.

5.10 Treating Drafts, Cheques as Cash Even if their Collection is Likely to Take Some Time: When a draft or a cheque is received from a third party, the proper entries are a credit to the party and simultaneous debit of the same amount to the bank through which the draft or cheque is collected. If some days elapse before the draft or cheque is sent to the bank and the bank is debited, the amount of the draft or cheque is shown as part of the 'cash balance' in the cash book. It is obvious that in such cases, the 'cash balance' should not fall below the amount of uncollected cheque or draft. Cases have been found in which expenses are met out of undisclosed cash and the closing 'cash balance' is shown at a figure less than the amount of uncollected draft or cheque.

5.11 Striking Cash Balance Periodically, say Fortnightly or Monthly: It will be found that payments exceed money available if daily cash balances are struck.

5.12 Inflating Receipt Side Total and Deflating Payment Side Total in Cash Book: This is a method subtler than the method of unledgerised cash credit. Where receipt side total is inflated there will be corresponding inflation of payment side total on a later date when cash is available. By this way cash secretly introduced earlier is withdrawn. If cash is introduced secretly by deflating the total of the payment side, there will be a corresponding deflation of the receipt side total later.

5.13 Artificially Splitting Entries: Every transaction involves a credit and a debit in the double-entry system of accounting. When, for instance, a credit purchase is made the vendor is credited and the goods account is simultaneously debited. An assessee, who maintains only a cash book and no journal, may credit the vendor today and debit the goods account, say after two months, meanwhile using the hidden cash under cover of artificial, inflated cash balance.

5.14 Showing Fictitious Cash Sales or Speculation Profits: The assessee may show fictitious cash sales or speculation profits when cash is required and subsequently showing fictitious cash purchases or speculation losses when cash is not longer required. The services of some brokers or other parties similarly interested in such manipulations are likely to be utilised in this connection.

6. CASH CREDITS-DEVICE TO INTRODUCE UNACCOUNTED CASH FOR LONG PERIOD

When large sums of money are needed for a long period, following are some of the methods adopted by the taxpayers:

6.1 Bank Loans: Opening secret fixed or call deposit account with banks in different names and obtaining loans on collateral security of those deposits.

6.2 Agricultural Income: Claiming large agricultural income, taking advantage of some landholding, the exact income from which is not easily ascertainable.

6.3 Sale Proceeds of Shares or Other Assets: Showing fictitious sales of shares or other assets through recognised brokers, the assets being acquired by the assessee himself with undisclosed income, and the undisclosed funds coming into the books in the form of sale proceeds.

6.4 Inflating Sale Price and Reducing Purchase Price: While selling share or other assets genuinely, the sale price is collusively arranged at an inflated figure. This enables the cash to the extent of the inflation in price to be introduced secretly. Similarly, while the shares or other assets are purchased genuinely, it is collusively arranged that the purchase price should be shown at a reduced figure. Here again secret funds to the extent of the difference

is brought into use, incidentally avoiding appropriate stamp duty.

6.5 Claiming Inheritance of Wealth: Claiming inheritance of wealth from father or other relatives where directly disproving the existence of such wealth is not possible or easy.

6.6 Claiming Accumulated Savings: Claiming accumulated savings over a period of time in the past out of declared drawings in that period.

6.7 By Taking Loan Entry: Advancing unaccounted money to a well-known party or an entry-operator and introducing the money in the books by way of a simultaneous loan from him. The unaccounted income may also be introduced in books by showing bogus hundi loans.

6.8 Floating a Company: Floating a limited company, holding its share or debenture capital with secret income in different names and taking loans from it subsequently.

6.9 Creating a Trust: Creating a charitable trust, making anonymous donations to it with secret income and taking loans from it.

6.10 Transferring Money Abroad: By transferring unaccounted money from India to foreign countries and later showing borrowals, gifts or investment from entities of those countries.

6.11 By Taking Entry of Long-Term Capital Gain on Sale of Penny Stock

6.11.1 Exemption provided under Section 10(38) of the income-tax Act,1961 has been often misused for declaring the unaccounted income as exempt long-term capital gains by entering into sham transactions.

6.11.2 As per Section 10(*38*), any income arising from the transfer of a long-term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust is exempt where (a) the transaction of sale of such equity share or unit is entered into on or after the date on which Chapter VII of the Finance (No. 2) Act, 2004 comes into force; and (b) such transaction is chargeable to securities transaction tax under that chapter. Obviously, the above exemption was available if the shares were acquired in any manner.

6.11.3 As per 3rd proviso of Section 10(38) inserted by Finance Act 2017, nothing contained in this Clause i.e. Clause 38 of Section 10 shall apply to any income arising from the transfer of a long-term capital asset, being an equity share in a company, if the transaction of acquisition, other than the acquisition notified by the Central Government in this behalf, of such equity share is entered into on or after the 1st day of October, 2004 and such transaction is not chargeable to securities transaction tax under Chapter VII of the Finance (No. 2) Act, 2004 (23 of 2004). As on 05/ 06/ 2017, the Government issued a notification no. 43/ 2017. So, after aforesaid amendment, to claim the exemption *u/s* 10(38), it is now also mandatory that the transaction of acquisition is carried through recognised stock exchange and STT should have been paid on such acquisition.

6.11.4 Following fourth proviso shall be inserted after the third proviso to Clause (38) of Section 10 by the Finance Act, 2018, w.e.f. 1-4-2019:

Provided also that nothing contained in this Clause shall apply to any income arising from the transfer of long-term capital asset, being an equity share in a company or a unit of an equity oriented fund or a unit of a business trust, made on or after the 1st day of April, 2018."

6.11.5 The aforesaid provisions of Section 10(38) have been misused by the taxpayers by taking accommodation entry of Long Term Capital Gain [LTCG]. Shares are purchased at abnormally low price. Thereafter, operators artificially increase the price of the share several times in a pre-determined collusive plan. The shares are sold subsequently through stock exchange after holding for 1 year. As these shares are not having any real value, the inflated sale proceeds are arranged by giving unaccounted

cash in lieu of sale proceeds to entry- operators who charge some undisclosed commission. The LTCG shown in the books have been exempt for a long period of time.

6.11.6 Now, it is pertinent to discuss how the aforesaid provisions have been misused by some of the taxpayers. Before the actual transaction start taking place there are brokers in different towns who contact prospective clients and take paper booking for entries. The commission to be paid to the operators is decided at this stage, however, no money is paid. Once the booking is complete, the operators have a reasonably good idea of how much LTCG is to be provided along with the break-up of individual beneficiaries. This data is essential to decide which penny stock or companies to use for the job and which beneficiary to buy how many shares.

6.11.7 Broadly speaking there are two types of companies.

i. **An old Already Listed Company**: The entire shareholding of which is bought by the syndicate to provide LTCG entries. These are generally dormant company with no business and with accumulated losses

ii. **A New Company:** Which is floated just for the purpose giving LTCG entries. Such new companies are often floated after the initial booking is complete and the capital base is decided keeping in mind the entries to be provided.

6.11.8 There are three categories of individuals who are involved in the transactions-

i. **Syndicate Members:** They are the promoters of the Penny Stock companies who own the initial shareholding mostly in the name of paper companies either in a fresh IPO or purchased from the shareholders of a dormant company. They are usually a group of 4–5 individuals who are also referred to as Syndicate Members and are sometimes also referred to as Operators. Their nominees are directors of the Penny Stock companies which is indirectly controlled by them through such dummy directors. The whole operation is managed by them. They get the net commission income from the transactions. Their name however, seldom appears in the actual transactions.

ii. **The Brokers:** They are registered brokers through whom shares are traded both online and off-line. They are fully aware of the nature of transactions and get paid a commission over and above their normal brokerage. Some of the big broking houses also indulge in such transactions, mostly through sub-brokers. The brokers often compromise on KYC norms of the clients to help the Syndicate Members.

iii. **The Entry Operators:** They are individuals who control a large number of paper/ shell companies which are used for routing cash for the transactions as well as buying and selling shares during the process of price rigging. They work for the commission paid by the Syndicate Members.

6.11.9 The transaction involves three legs.

i. **Purchase of Share by the Beneficiary:** The beneficiary is sold a fixed number of shares at a nominal rate. The price and the number of shares to be purchased are decided on the basis of the booking taken and the value up to which price would be rigged. This leg of the transaction mostly is off-line. This is done to save on STT using the loophole in Section 10(38) of the IT Act which places restriction of trading by payment of STT on sale of shares and not on purchase.

ii. **Price Rigging:** After the shares have been purchased by the beneficiaries, the syndicate members start rigging the price gradually through the brokers. In

these transactions the volume is almost negligible. Two fixed brokers who are in league with the Syndicate buy shares at a fixed time and at a fixed price. These low volume transactions are managed through paper companies of entry operators.

iii. **Final Sale by the Beneficiary:** This is done after the beneficiary has already held the share for one year. The period of holding may be a little more to match the amount of booking with the final rate. The beneficiary is contacted either by the Syndicate member or the Broker (Middle man) through whom the initial booking was done. The beneficiary provides the required amount of cash which is routed through some of the paper companies of the entry operator and is finally parked in one company which will buy the share from the beneficiary. The paper company issues cheque to the beneficiary.

6.11.10 The abovementioned methodology is referred to as Conventional Method. Another method which was also used quite often is called Merger Method. In Merger method, the operators first form a Private Limited Company and the shares at par are allotted to beneficiary individuals. This private limited company is then amalgamated/ merged with a listed penny stock company by a High court order. Depending on the capital of the amalgamating and amalgamated companies, the investors are allotted stock of the listed companies in the same proportion. The capital of the Penny stock listed company and the private limited company are so arranged that the beneficiaries post- merger, get shares of listed company in the ratio 1:1, thus the investor gets equal number stocks of the listed company. The promoters of the listed penny stock companies run the syndicate, the brokers and the entry-operators through whose paper/ shell companies cash are routed are merely commission agents. The penny stock listed company is such that though its capital base is small its market capitalisation is many times its capital base. This is managed again through small volume predetermined transaction amongst members of the syndicate. The prices of shares are thus manipulated at 20 to 25 times the face value. The investors hold the shares of the penny stock listed company which it got as a result of merger for one year (statutory lock-in period for exemption under IT Act) and then sell it to one of the shell companies of the operator. The investor thus makes a LTCG of 20–25 times its original investment. The purchase consideration is again provided in cash by the investor which is laundered to the buyers account through a maze of shell companies as mentioned in the previous method.

7. EXAMINING CASH CREDITS

7.1 Cash credit may simply appear as a single credit entry in an account. The account may appear as a closed account in which case the cash credit may be followed by a corresponding debit entry. Or, it may be preceded by a corresponding debit entry made either in that year or in an earlier year. Besides these types, there may be accounts showing numerous credit and debit transactions in which case the account may be called cash credit-cum-drawing account. In such cases it may be a fruitful to find out if such accounts represent current banking accounts of some concealed business. If it is established that the account represents banking account of some undisclosed business, it would be more appropriate to consider only the net credit as income, but even in such cases the assessee should establish that such is in fact the case.

7.2 Except under special circumstances, it is the gross cash credits that are relevant. Any drawings should not be accepted automatically or necessarily to be the genuine source of the later credits. When an assessee urges that the drawings are the source of credits, the position is exactly the same as when he urges that the credits coming out of cash savings at home or cash received from legacies etc. The only

difference when drawings are offered as the source of later credits is that the existence of the drawings cannot be denied. But that does necessarily prove that the later credits should be deemed in fact to have come out of such drawings as the assessee could have spent them in hundreds of other ways. A realistic approach would base itself on three propositions:

i. That, the only basis on which the net credits theory could be validly founded would be on the assumption that the drawings were not for investing them but for keeping the money at home.

ii. That, the assumption required for this proposition is so contrary to normal expectations that it cannot be accepted without proof that the money was in fact kept at home.

iii. That, in absence of such proof the gross credit theory must remain as it is based on the relatively more secured foundation that the surplus funds, when not allowed to remain in business must have been drawn out for only two reasons, *viz.*,(a) expenses, and, or, (b) investment, and so it is for the assessee to prove that the money had been kept intact and was available when needed.

7.3 When an assessee produces his books of account before an AO in support of a return, there is an initial presumption in his favour that the books have not been fabricated. This presumption is an application of the general presumption which the law raises against misconduct of every kind including crime, fraud, forgery, dishonesty and fabrication. But when an AO issues a notice under Section 143(2) of the income-tax Act, the principle of Section 106 of the Evidence Act commences to operate. The transaction recorded in the books being a fact particularly within the knowledge of the assessee, the onus of proving the correctness of the entry, the truth of which is called in question by the AO, shifts to the assessee. If the assessee fails to discharge this onus, the AO is free to draw his own inference from the inability of the assessee to explain what was within his knowledge and from the other circumstances of the case.

7.4 The following provisions of the Indian Evidence Act should be kept in mind -

S.106: When any fact is especially within the knowledge of any person, the burden of proving that fact is upon him.

S.114: The Court may presume the existence of any fact which it thinks likely to have happened, regard being had to the common course of natural events, human conduct and public and private business, in their relation to the facts of the particular case.

8. DEALING WITH VARIOUS TYPES OF EXPLANATIONS

8.1 In tackling cash credits, it is necessary for the AO to observe closely the various aspects connected with them and subject the assessee and the depositors in whose names cash credits appear to a searching cross-examination.

8.2 Given below is an outline as to how an AO may proceed to collect adequate materials to deal with explanations furnished by the assessees in support of cash credits. The appropriate enquiries will naturally depend on the facts of the case under consideration.

8.3 Entry of Long-Term Capital Gain on Sale of Penny Stock

8.3.1 In the recent past, the Investigation Wings of the Department have conducted investigation in case of the accommodation entry of Long Term Capital Gain (LTCG) on a much larger scale. They have been able to identify a very large number of beneficiaries who have taken bogus entries of LTCG. First, the ‹Penny Stocks' were identified by them and then the individuals who dealt in them were identified by collecting data of transactions from stock exchange.

8.3.2 The share brokers, the promoters of the penny stock companies, the entry -operators providing fund for purchase of shares through paper companies in lieu of accepting unaccounted money from different taxpayers were covered by the Investigation Wing and their statements along with other incriminating documents were recovered. Cash trails right from cash deposit accounts to the accounts of beneficiaries were also drawn in many cases. Some of the beneficiaries have also been covered who admitted to have taken accommodation entries.

8.3.3 SEBI has also taken actions against some of the companies and their promoters, whose shares have been manipulated to provide LTCG which would be available on their website.

8.3.4 Before the AO, the assessee generally submits various documentary evidences to prove the genuineness of the transaction of sale and purchase of shares which include a copy of purchase and sale bill, a copy of share transfer form, copy of bank statements, Demat account etc. The AO can reject the claim made by the assessee by doing some investigation at his own end in addition to relying on the report of the Investigation Wing. By examining the past history and assessment records of the assessee, it may be highlighted that the assessee does not indulge in purchase and sale of shares regularly except the few manipulated ones. Recording proper and detailed statement of the assessee will be a very useful tool. When and how the purchase consideration was paid and entered in the books will be a relevant factor to prove that the purchase shown was an afterthought. Thus the assessee's own conduct has to be brought on record to prove that the transactions are not normal in addition to referring and relying on the report of the Investigation wings and SEBI. Reliance is to be placed on those reports without losing focus on highlighting inconsistencies or abnormalities in transactions conducted by the assesssee. In case it is found that specific evidence or specific statement are not adequate against the assessee; the AO should conduct survey actions and examination *u/s* 131 or enquiry *u/s* 133(6) against the assessee and the operators.

8.4 Cash Credits Representing Sale Proceeds of Gold or Ornaments: It is a common practice to explain cash credits as representing sale proceeds of family ornaments. When asked to produce evidence in support of this, a letter from some reputed firm or bullion merchant, which hardly shows any details of the transaction, is produced. Secret profits are sometimes first converted into gold and jewels and later on disposed of through bullion merchants. Often these merchants collaborate with such assessees and help them by furnishing back-dated vouchers and by making ante-dated entries in their account books. For this purpose, these merchants generally leave sufficient space in their account books so that at a later date, entries could be easily interpolated. If such transactions are properly investigated, it may not be difficult to establish that these entries in the books are distinctly different from the other normal entries in that the hand-writing is not the same or there is slight variation in the colour of the ink used. However, in computerised books, it is difficult to find out such entries inserted subsequently. Wherever necessary it would be better to call for accounts of the purchasers. It should be borne in mind that it is not the general practice to sell family ornaments unless the owner is driven to the extreme. In times of difficulty the ornaments may be pledged but out-right sale is not generally resorted to.

8.5 Cash Credits Alleged to have Come out of Agricultural Income: In those states where agricultural income-tax is levied, there may not be much difficulty in scrutinising the explanation. But where such tax is not levied and the assessee does not keep any record of his agricultural income and expenditure, or even if he keeps a record but does not produce it, the AO should inquire about the extent of the agricultural holding, extent of land cultivated, nature of crops

cultivated, the extent of yield, purchase of seeds and other inputs, extent of irrigation, facilities of storage, the maximum possible sale proceeds of the yield, and particulars of the purchasers.

8.6 Cash Credits Alleged to have Come out of Foreign Gifts: Money brought into India by non-residents for investment or other purposes is not liable to Indian income-tax. The question of assessment to tax arises only when there is no evidence to show, that the amount in question in fact represents such remittance. Certain instances have come to notice, wherein gifts were purported to have been received from non-residents who were totally strangers to the donors. The modus-operandi in such cases was to purchase foreign currency in India and later on depositing the same in the non-resident external accounts maintained in certain banks by the non-residents from where the gifts were alleged to have been given to these assessees. On detailed investigation, it was discovered that the assessees in connivance with the bank officers and the non-residents arranged to purchase foreign currency from the local market, depositing the same in the NRE accounts and then receiving cheques of identical amounts in the guise of gifts. While examining such credits, all factors in totality have to be considered by the AO. The truthfulness of statements advanced by the assessee can also be tested against the human probabilities. If there is sufficient indication based on the probabilities of an occurrence to disbelieve the statements made by the assessee, even when advanced with *prima-facie* evidence, the AO may be justified in disbelieving the statements. [*Sumati Dayal vs. CIT* 214 ITR 801 (SC)]. The ratio of the Supreme Court judgment has far more implication now when the Gift Tax Act is not in operation, and when gifts are freely made. The relationship between the parties and other related aspects may have to be examined by the AO before he accepts the claim of gifts as genuine. Besides in each instance of cash credit, the assessee has necessarily to establish the following:

i. The identity of the creditor or the donor,

ii. The capacity of the creditor or the donor to advance or gift the money, and

iii. The genuineness of the transaction.

8.7 Cash Credits Alleged to have Come out of Previous Withdrawals: The AO should scrutinise the withdrawals made in earlier years. The narration in the Cash Book in respect of withdrawals should be seen. It should be borne in mind that normally no one withdraws large sums of money to keep it idle at home. The AO should see whether withdrawals could be properly correlated to expenses for marriages in the family, gifts, properties purchased etc. In the absence of positive proof to the contrary, one should infer that cash credits should be treated as income and the withdrawals as money taken either for expenses or for investment elsewhere.

8.8 Cash Credits in the Name of a Third Party: The AO should note down briefly the assessee's family history, the age and sources of income of each of the members of the family, what births and deaths occurred in the previous year under consideration, how many marriages were celebrated in the year, what were the names of the principal employees and so on. He will thus be familiar with the assessee's background, and will be in a position to know whether the alleged creditor is merely a member of the family or an employee. Then the cash credits and debits may be examined individually item by item. How was the money brought and how returned? If cash was brought, who brought it and how is he connected with the assessee? If a cheque was brought, the number of the cheque or the draft, its date and amount and the name and address of the Bank on which it was drawn should be noted. It should be found out from the Bank who exactly drew the cheque or purchased the draft, and, in the case of the cheque, who operated the

Bank account relating to it and who introduced the owner of the account to the Bank. He will also have to see whether the money was urgently needed by the assessee and why it was needed at all, whether any interest was paid, whether interest if paid is reasonable or only nominal, and whether the assessee had any transaction with the alleged creditor earlier or later. Then he can get local enquiries made at the address furnished for the creditor by the assessee. Is he a genuine person or is he merely imaginary? Is he a man of straw or a person capable of possessing or advancing the amount of credit without damage to his own livelihood. Does he pay income-tax himself? What are his antecedents? Does he maintain books of account? Is he either closely or remotely connected with the assessee? How did the assessee come into contact with him, if he is professed to be a stranger? Did the creditor ever advance any cash to any other person at any time? If he did, the other debtors concerned can be asked to give particulars of their transactions with him. What happened to the money after it was withdrawn by the creditor from the assessee? Where and how has it been kept?

8.9 Cash Credits in the Name of Assessee's Wife or in the Name of Coparcener of an H.U.F.: The proper approach to cash credits of this type is the one adopted in respect of credits in the name of a third party. It is necessary to bring some material on record to suggest that the amounts in question belonged to the husband or the joint family as the case may be. It is possible that the cash credited to the wife or the coparceners belonged to the husband or the family; but that possibility will not become a probability if further enquiries are not made. Are there any circumstances suggesting that the family is withholding information bearing on its income? Do the members who are supposed to have cash have any ostensible source of income? Do they have a reasonable explanation for the source of the money otherwise? What is the history or background of the money? How was it contributed? Where was it kept earlier? The decision must obviously vary with the facts of each case.

8.10 Credits Appearing in the Name of Declarants of Voluntary Disclosure Income Scheme/ IDS: The general principle of all VDIS is that the immunity is granted to the declarant and the declarant also gets such immunity provided it is an honest and truthful disclosure. However, when the moneys declared by a declarant are credited in the books of a third party, the AO assessing the third party must enquire into the source of the deposit. In case, he is not satisfied with the explanation offered by the assessee, the amount so credited has to be included in the total income of the assessee. The immunity under VDIS will not be available to the third party. This is the ratio of the Supreme Court judgment in the case of *Jamna Prasad Kanhaiya Lal vs. CIT* 130 ITR 244.

8.11 Credits Appearing as Share Application Money: Generally it is believed that credits appearing as share application money need not be enquired into, as the Company cannot be called upon to discharge the onus cast upon it under Sec. 68 of the I.T. Act. However, nothing precludes the AO from making an enquiry as to the true nature and source thereof even if the same is credited as receipt of share application money. The AO is entitled to enquire whether the alleged shareholders do in fact exist at all and if he finds that the alleged shareholders do not exist, then he would be justified in treating the share capital or part thereof as income of the company. This issue is now by and large settled by the Delhi High Court in the case of *CIT vs. Sophia Finance Ltd.* 205 ITR 98(F.B.).

9. SOP REGARDING CASH CREDIT ISSUED BY CBDT DATED 10.01.2018

9.1 The Standard Operating Procedure for applying provisions of Section 68 of income-tax Act, 1961 was issued on 10.01.2018 and

the same should be followed by the Assessing Officers. It has been emphasized in the aforesaid SOP that the AO should give a detailed reasoning in the assessment order for not accepting the explanation of the assessee. The reasons for not accepting the explanation of the assessee should be communicated to the assessee. The order passed by the AO should be speaking one. Relevant case laws should be relied upon wherever possible.

9.2 Some of the legal positions clarified in the said SOP are as under:

9.2.1 Meaning of the Term "Books"

i. The term 'books' of the assessee maintained for any previous year has invited judicial scrutiny by various courts with reference to what constitutes "books". The Hon'ble Supreme Court in *Shri V.C. Shukla vs. CBI* [1998] 3 SCC 410 has discussed the meaning of the term "books":

"'Book' ordinarily means a collection of sheets of paper or other material, blank written, or printed, fastened or bound together so as to form a material whole. Loose sheets or scraps of paper cannot be termed as 'book' for they can be easily detached and replaced."

ii. The term "books of Account" was inserted by the Finance Act, 2001, w.e.f. 1-6-2001 *u/s* 2(12A) of the Act which is as under:

"books or books of account" includes ledgers, day-books, cash books, account books and other books, whether kept in the written form or as print-outs of data stored in a floppy, disc, tape or any other form of electro-magnetic data storage device;"

9.2.2 Burden of Proof-Explanation of the Assessee

The expression "the assessees offers no explanation" has been analysed by Hon'ble Supreme Court in various cases. Relevant portion from following case laws are extracted below:

iii. *CIT vs. P. Mohanakala* [2007] 161 Taxmann 169 (SC)

"The expression "the assessees offers no explanation" means where the assessees offer no proper, reasonable and acceptable explanation as regards the sums found credited in the books maintained by the assessees. It is true that the opinion of the Assessing Officer for not accepting the explanation offered by the assessees as not satisfactory is required to be based on proper appreciation of material and other attending circumstances available on record. The opinion of the Assessing Officer is required to be formed objectively with reference to the material available on record. Application of mind is the sine qua non for forming the opinion".

iv. *Kale Khan Mohammad Hanif vs. CIT* [1963] 50 ITR 1 (SC)

"It is well established that the onus of proving the source of a sum of money found to have been received by the assessee is on him. If he disputes liability for tax, it is for him to show either that the receipt was not income or that if it was, it was exempt from taxation under the provisions of the Act. In the absence of such proof, the income-tax Officer is entitled to treat it as taxable income".

v. *Sumati Dayal vs. CIT* [1995] 80 Taxmann 89 (SC)/ 214 ITR 801 (S.C).

Assessee had shown certain amounts in capital accounts in books claiming same to be winnings from horse races. She filed sworn statement to effect that she started going for races only towards end of year 1969 and had no experience in races but she purchased jackpot tickets on combination worked out by her on basis of advice

given by her husband. She had allegedly won 16 jackpots besides trebles. Assessing Officer disbelieved her version and taxed amount as income from undisclosed sources. Settlement Commission by its majority order upheld assessment order holding that it was reasonable to infer, on facts, that assessee did not participate in races but purchased winning tickets after events with unaccounted money. It was held by the Apex Court that the matter in question had to be considered in light of human probabilities and surrounding circumstances. Having regard to conduct of assessee as disclosed by her in sworn affidavit as well as other material on record, an inference could reasonably be drawn that winning tickets were purchased by her after race event and therefore the amount in question was not winnings from horse races but income from undisclosed sources.

vi. *Sreelekha Banerjee vs. CIT* (1963) 49 1TR 112 (SC)

"It seems to us that the correct approach to questions of this kind is this. If there is an entry in the account books of the assessee which shows the receipt of a sum or conversion of high denomination notes tendered for conversion by the assessee himself, it is necessary for the assessee to establish, if asked, what the source of that money is and to prove that it does not bear the nature of income. The Department is not at this stage required to prove anything. It can ask the assessee to bring any books of account or other documents or evidence pertinent to the explanation if one is furnished, and examine the evidence and the explanation. If the explanation shows that the receipt was not of an income nature, the Department cannet act unreasonably and reject that explanation to hold that it was income. lf, however, the explanation is unconvincing and one which deserves to be rejected, the Department can reject it and draw the inference that the amount represents income either from the sources already disclosed by the assessee or from some undisclosed source. The Department does not-then proceed on no evidence, because the fact that there was receipt of money, is itself evidence against the assessee. There is thus prima facie evidence, against the assessee which he fails to rebut, and being unrebutted, that evidence can be used against him by holding that it was a receipt of an income nature. The very words "an undisclosed source" show that the disclosure must come from the assessee and not from the Department".

vii. *Vijay Kumar Talwar vs. CIT* (2011) 330 ITR 1 (SC)

"22. Examined on the touch-stone of the afore-noted legal principles, we are of the opinion that in the instant case the High Court has correctly concluded that no substantial question of law arises from the order of the Tribunal. All the authorities below, in particular the Tribunal, have observed in unison that the assessee did not produce any evidence to rebut the presumption drawn against him under Section 68 of the Act, by producing the parties in whose name the amounts in question had been credited by the assessee in his books of account. In the absence of any cogent evidence, a bald explanation furnished by the assessee about the source of the credits in question *viz.,* realisation from the debtors of the erstwhile firm, in the opinion of the Assessing Officer, was not satisfactory. It is well settled that in view of Section 68 of the Act, where any sum is found credited in the books of the

assessee for any previous year, the same may be charged to income-tax as the income of the assessee of that previous year, if the explanation offered by the assessee about the nature and source thereof is, in the opinion of the Assessing Officer, not satisfactory. *See: Sumati Dayal vs. CIT* [1995] 80 Taxmann 89 (SC) and *CIT vs. P. Mohanakala* [2007] 161 Taxmann 169 (SC). We are of the opinion that on a conspectus of the factual scenario, noted above, the conclusion of the Tribunal to the effect that the assessee has failed to prove the source of the cash credits cannot be said to be perverse, giving rise to a substantial question of law. The Tribunal being a final fact finding authority, in the absence of demonstrated perversity in its finding, interference therewith by this Court is not warranted."

9.2.3 Ingredients of the Assessee's Onus

Hon'ble Kerala High Court in case of *M.A. Unneeri Kutty vs. CIT* (1992) 198 ITR 147, 150 (Ker.), SLP dismissed by Hon'ble Supreme Court: (1993) 201 ITR (st.) 23] while examining ingredients of assessee's onus has held as under:

It cannot be doubted that it is for the assessee to prove the identity of the creditor as also the creditworthiness. The genuineness of the transactions should be proved. In view of the above decisions, the explanation offered by the assessee must have the above 3 ingredients:

i. *Identity* of the creditor

ii. *Creditworthiness of the* creditor i.e. capacity of the *creditor to advance the money*

iii. *Genuineness* of the transactions

Once the assessee has proved the above three ingredients simultaneously and adduce evidence to establish prima facie the aforesaid, the onus shifts on the Department

From a careful perusal of the above decisions, it is established that primary onus to prove identity of creditors, capacity of such creditor to advance the money and the genuineness of the transaction is on the assessee. The Hon'ble Supreme Court has also held that explanation offered by the assessee should be carefully examined by the AO to ascertain whether all the ingredients of the onus are proved *by* the assessee or not.

9.2.4 Applicability of Section 68 in Cases of "Accommodation Entry" in Respect of Share Application Money/ Share Premium

The earlier view of Hon'ble Delhi High Court in the case of *Stellar Investment Ltd*. [192 ITR 287] and *Lovely Exports Pvt Ltd.* [299 ITR 268]was that share capital cannot be added in the hands of the assessee company once the assessee furnishes PAN, addresses of the creditor/subscriber along with copies of the shareholders register, share application forms, share transfer register, etc. This would constitute sufficient explanation by the assessee. The Hon'ble Supreme Court was in agreement with above decisions of Delhi High Court, however, on conclusion of facts only without answering the ratio laid down as sought to be pronounced by Delhi High Court [Ref*: Hindustan Tea Trading Co. Ltd. vs. CIT* 263 ITR 289 (Cal)].

However, subsequently, the above decisions of the Hon'ble Supreme Court and Delhi High Court have been considered by various Courts including Delhi High Court itself. Based on the findings of facts and detailed investigations, these courts have distinguished the observations of the Hon'ble Supreme Court in Stellar Investment Ltd and Lovely Exports Pvt. Ltd. and have upheld the invoking of Section 68.

iv. *CIT vs. Nova Promoters and Finlease (P.) Ltd.* [2012] 342 ITR 169 (Delhi)

The decision in the case of *Lovely Exports Ltd.* was considered in *Nova Promoters and Finlease (P) Ltd*. and it was held as under-

"38. -----*We are afraid that we cannot apply the ratio to a case, such as the present one, where the Assessing Officer is in possession of material that discredits and impeaches the particulars furnished by the assessee and also establishes the link between self-confessed "accommodation entry providers", whose business it is to help assessees bring into their books of account their unaccounted monies through the medium of share subscription, and the assessee.------"*

Finally, in Nova Promoters & Finlease, it was held that in view of the link between the entry providers and incriminating evidence, mere filing of PAN number, acknowledgement of income-tax returns of the entry provider, bank account statements etc. was not sufficient to discharge the onus.

v. *Hindusthan Tea Trading Co. Ltd. vs. CIT* 263 ITR 289 (Cal)

"In Steller Investment Ltd.'s case [2001] 251 ITR 263, the apex court had passed the following order: "We have read the question which the High Court answered against the Revenue. We are in agreement with the High Court. Plainly, the Tribunal came to a conclusion on facts and no interference is called for. The appeal is dismissed. No order as to costs." From the above observation, it appears that the Supreme Court has not entered into the question involved or has not decided the ratio laid down. It had plainly held that it was a question of fact. The Supreme Court has not laid down any proposition with regard to the question. It was purely a question of fact with which the apex court had dealt with and was in agreement with the High Court on conclusion of facts. Therefore, it cannot be said that the Supreme Court answered the ratio laid down as sought to be propounded by the Delhi High Court in *Stellar Investment Ltd.'s* case [1991] 192 ITR 287. A decision becomes binding as a precedent only when the court decides a particular question of law or lays down the ratio through conscious adjudication"

vi. *CIT vs. Nipun Builders and Developers P. Ltd.* [2013] 350 ITR 407 (Delhi)

Share application money was received in Assessment year 2004–05 from different companies. Assessing Officer issued summons to subscriber companies which were returned unserved with remarks 'no such company'. Inspector sent to addresses for verification confirmed said fact. Moreover, assessee failed to produce principal officers of subscriber companies who could explain sources from which share subscription was made. In aforesaid circumstances, Assessing Officer was justified in adding share subscription money to assessee's taxable income as unexplained deposits.

vii. *CIT vs. N. R. Portfolio Pvt. Ltd.* [2014]42 taxmann.com 339 (Delhi)

"30. What we perceive and regard as correct position of law is that the court or tribunal should be convinced about the identity, creditworthiness and genuineness of the transaction. The onus to prove the three factum is on the assessee as the facts are within the assessee's knowledge. Mere production of incorporation details, PAN Nos. or the fact that third persons or company had filed income-tax details in case of a private limited company may

not be sufficient when surrounding and attending facts predicate a cover up. These facts indicate and reflect proper paper work or documentation but genuineness, creditworthiness, identity are deeper and obtrusive. Companies no doubt are artificial or juristic persons but they are soulless and are dependent upon the individuals behind them who run and manage the said companies. It is the persons behind the company who take the decisions, controls and manage them."

viii. *CIT vs. Gold Leaf Capital Corporation Ltd.* [2013] 353 ITR 163 (Delhi)

The Hon'ble Court concurred with the view of the Hon'ble Tribunal and observed that:

The conduct of the assessee has been beautifully summarized by the Tribunal itself in the following manner:

"All this is again indicative of the fact that in fact the assessee from day one of initiation of initial assessment proceedings was in a position to exercise control on the investing companies and still it withheld all the necessary information called for by the Assessing Officer, which could enable the Assessing Officer to test the genuineness of the transaction and creditworthiness of the investing companies by verifying the genuineness of the claims made by the assessee before the CIT (A) on the basis of those documents which the assessee filed for the first time before the CIT (A) during the 2nd inning or the appellate proceedings.

Thus, it stands established that in fact the assessee produced only the information/ documents/ person for recording statement called for by the Assessing Officer which suited the interest of the assessee and intentionally withheld that information which did not suit the interest of the assessee."

ix. *CIT vs. Navodaya Castles (P.) Ltd.* [2014] 367 ITR 306 (Delhi)

"13. As we perceive, there are two sets of judgments and cases, but these judgments and cases proceed on their own facts. In one set of cases, the assessee produced necessary documents/ evidence to show and establish identity of the shareholders, bank account from which payment was made, the fact that payments were received thorough banking channels, filed necessary affidavits of the shareholders or confirmations of the directors of the shareholder companies, but thereafter no further inquiries were conducted. The second set of cases are those where there was evidence and material to show that the shareholder company was only a paper company having no source of income, but had made substantial and huge investments in the form of share application money. The assessing officer has referred to the bank statement, financial position of the recipient and beneficiary assessee and surrounding circumstances. The primary requirements, which should be satisfied in such cases is identification of the creditors/ shareholder, creditworthiness of creditors/ shareholder and genuineness of the transaction. These three requirements have to be tested not superficially but in- depth having regard to the human probabilities and normal course of human conduct.

14. Certificate of incorporation, PAN etc. are relevant for purpose of identification, but have their limitation when there is evidence and material to show that the subscriber was a paper company and not a genuine investor. It is in this context, the Supreme Court in CIT Durga Prasad More [1971] 82 ITR 540 (SG) had observed:

"Now we shall proceed to examine the validity of those grounds that appealed to the learned judges. It is true that the apparent must be considered real until it is shown that there are reasons to believe that the apparent is not real. The taxing authorities were not required to put the blinkers while looking at the documents produced before them. They were entitled to look into the surrounding circumstances to find out the recitals made in those documents"

The Hon'ble Supreme Court rejected the SLP filed in the above case *Navodaya Castle (P.) Ltd. vs. CIT* [2015] 56 taxmann. com 18 (SC) with the observation:

"We do not see any merit in this special leave petition, which is hereby dismissed".

x. *Onassis Axles P. Ltd. vs. CIF* [2014] 364 ITR 53 (Delhi)

"14. Lovely Exports Pvt. Ltd. (supra) is an authority for the proposition that the assessee is under an obligation to dispel any doubts regarding the genuineness of an investor and the genuineness of the transaction. Here, though the assessee furnished particulars relating to three share applicants, the further inquiry made by the Assessing Officer raised more questions than answers. The share applicants' lack of resources, the assessee's position vis-á-vis share amounts received and its commercial condition all pointed to the amount received by it falling within the mischief of Section 68 as unexplained amounts. That the Assessing Officer or the income-tax Appellate Tribunal chose to treat the amount, as bogus share capital, is a matter of inference which the court would be loath to interfere with.

15. For the above reasons, this court answers the question framed, in favour of the Revenue and affirms the view of the income-tax Appellate Tribunal. The appeal is, therefore, dismissed, with no order as to costs."

xi. *Commissioner of Income-tax-II vs. Jan Sampark Advertisement & Marketing Pvt. Ltd.* [2015] 375 ITR 373 (Delhi)

When Assessing Officer sets about seeking explanation for unaccounted credit entries in books of account of assessee in terms of Section 68, it is legitimately expected that exercise would be taken to logical end, in all fairness taking into account material submitted by assessee in support of his assertion that person making payment is real, and not non-existent, and that such other person has actually source of money forming subject matter of transaction and that transaction is real and genuine. Whether however as two appellate authorities, *viz.*, Commissioner (Appeals) and Tribunal, are also forums for fact-finding, in event of Assessing Officer failing to discharge his functions properly, obligation to conduct proper inquiry on facts would naturally shift to door of said appellate authorities and they having noticed want of proper inquiry, cannot close chapter simply by allowing appeal and deleting additions made.

10. OTHER RELEVANT DECISIONS

10.1 It is for assessee to prove the identity of creditors, their creditworthiness and the genuineness of the transaction; mere furnishing of the particulars is not enough; mere payment by account-payee cheque is not sacrosanct nor can it make a non-genuine transaction genuine. *CIT vs. Precision Finance (P) Ltd.* [208 ITR 465(Cal.)]

10.2 Even where, with regard to third party cash credits in the assessee's books, the assessee produces the party who owns the cash credit, the assessee has not discharged onus of proving

the genuineness of the credit unless it is also established that the third party is not a man of straw but a person capable of possessing the amount represented by the cash credit. *Nanakchand Laxmandas vs. CIT* [140 ITR 151 (Alld.)]

10.3 Use of the words ' any sum found credited in the books' in Section 68 indicates that the said Section is very widely worded and the AO is not precluded from making an enquiry as to the true nature and sources thereof, even if the same is credited as receipt of share application money. *CIT vs. Sophia Finance Ltd.* 205 ITR 98 (Delhi) (FB) *CIT vs. Pratik Finance & Invt. Co. Ltd.* 215 ITR 272(Delhi)

10.4 The assessee received certain amount as share capital from different parties. It was noted from records that summons served to shareholders under Section 131 were unserved with remark that addressees were not available. It was also found that shareholders were first time assessees and were not earning enough income to make deposits in question. The assessee did not offer to procure presence of shareholders. In view of above mentioned facts, the assessee failed to prove genuineness of share transactions and, thus, impugned addition under Section 68 was to be confirmed. [*Konark Structural Engineering (P.) Ltd. vs. DCIT* [2018] 90 taxmann.com 56 (Bombay)]

SLP filed by the assessee against the aforesaid decision of Bombay High Court in case of Konark Structural Engineering (P.) Ltd. was dismissed. [*Konark Structural Engineering (P.) Ltd. vs. DCIT* [2018] 96 taxmann.com 255 (SC)]

10.5 Where assessee received loan from two companies, in view of fact that on date assessee was given loan there were credit entries of almost similar amounts and balance after these transactions was a small amount and moreover assessee failed to produce these lenders for verification, impugned amount was rightly brought to tax under Section 68. [Pavankumar *M. Sanghvi vs. ITO* [2018] 90 taxmann.com 386 (Gujarat)]

10.6 Mere confirmation alone is not sufficient. The confirmation is required to be decided and/ or considered along with the financial capacity of the person who alleged to have given the unsecured loan and/ or gift. [*Sitaram Ramchanddas Patel vs. ITO* [2018] 95 taxmann.com 290 (Gujarat)]

10.7 Where AO made addition under Section 68 in respect of increase in share capital of assessee-company, in view of fact that addresses of most of purported shareholders were identical and they could not be traced out despite notice issued under Section 131, Tribunal was justified in confirming impugned addition. [*DRB Exports (P.) Ltd. vs. CIT* [2018] 93 taxmann.com 490 (Calcutta)]

10.8 Assessee-company had received share application money from UAE based NRI. Assessee had only submitted a copy of acknowledgment of filing return of income of NRI wherein she had shown a meagre income which was not in proportion to money advanced by way of share application. Copies of her capital a/c, Balance Sheet, bank statement, etc., were not submitted. Besides this, assessee had not filed any details/evidence as to her activities in Dubai and her source of income in Dubai to substantiate her financial capacity. There was no evidence as to permanent address of residence/ office of NRI in Dubai. In view of aforesaid facts, the assessee had not discharged onus of proving creditworthiness and, thus, addition had to be made under Section 68. [*ITO vs. Spartacus Farms (P.) Ltd.* [2018] 91 taxmann.com 15 (Mumbai - Trib.)]

10.9 Where AO made addition to assessee's income in respect of loan availed, in view of fact that lender company did not have tangible or intangible fixed assets and, moreover, it had declared a meagre income of few thousand

rupees and, thus, it was not in a position to give such a huge loan to assessee, impugned addition was to be confirmed [*Seema Jain vs. ACIT* [2018] 96 taxmann.com 307 (Delhi)]

10.10 Even though shares had been issued at a very high premium to new shareholders, yet assessee could not even give correct addresses of three applicant companies where they were located. Further, assessee did not file any cogent material/ evidences to justify chargeability of such a huge share premium from three new shareholders *vis-á-vis* issuing shares at par to original promoters within same relevant year under consideration. It was also undisputed that three companies paying huge amount to assessee, had miniscule paid up capital and earned very small profits and, thus, they were not in a financial condition to subscribe to assessee's shares at such a high premium. In aforesaid circumstances, Assessing Officer rightly concluded that assessee failed to prove identity of parties and genuineness of share transactions and, thus, impugned addition was to be confirmed [*Pratik Syntex (P.) Ltd.* [2018] 94 taxmann.com 12 (Mumbai - Trib.)]. (This case was related to AY 2012–13].

10.11 Where assessee claimed to have received advances towards booking of plots but could not produce details of all applicants who paid said sum, Tribunal was justified in making additions under Section 68 to extent where details of applicants were not produced. [*Om Land Realty (P.) Ltd.* [2017] 86 taxmann.com 226 (Gujarat)]

10.12 Where AO made addition to assessee's income under Section 68 in respect of loan taken from various parties, since assessee failed to prove that any of those creditors had financial strength to lend such huge sums of money to assessee, that too without any collateral security, without interest and without a loan agreement, impugned addition deserved to be confirmed. [*PCIT vs. Bikram Singh* [2017] 85 taxmann.com 104 (Delhi)]

10.13 The assessee received loan from various parties but did not furnish confirmations in respect of those amounts. Assessee raised an objection that he had not maintained books of account and, therefore, amount in question could not be added to his income under Section 68. It was held that when assessee was doing business, then it was incumbent on him to maintain proper books of account and since he failed to do so, he could not be allowed to take advantage of his own wrong. Therefore, having regard to assessee's failure to produce relevant documents and explain nature and source of amount received by him, impugned addition *u/s* 68 was to be confirmed. [*Arunkumar J. Muchhala vs. CIT* [2017] 85 taxmann.com 306 (Bombay)]

10.14 Section 68 is applicable where cheques received by assessee from various creditors were not presented for collection in banks, still amount mentioned in those cheques were found credited in assessee's books of account. [*Vimal Organics Ltd. vs. CIT* [2017] 82 taxmann.com 427 (Allahabad)]

10.15 The heading 'Cash credits' is attached to Section 68. The headings prefixed to a Section cannot control clear and unambiguous words of the provision. Only in the case of ambiguity or doubt the heading or sub-heading may be referred to as an aid in construing the provision. What is referred to in Section 68 is where any sum is found credited in the books of an assessee and in the ends what is mentioned is the sum so credited may be charged to income-tax. Therefore, in the body of the Section, the word used is either found credited or so credited, there is no indication in the Section that such a credit should be a cash credit. It may be a cash credit or it may be a credit representing the value of the supplies made by the suppliers on credit. The essence is that the credit should be shown in the account and that would satisfy the requirement of Section 68 of the Act. Once the

credit so mentioned in the Section is found to be not supported by any acceptable evidence, then the sum so credited may be charged to income-tax as the income of the assessee of that previous year. [*Smt. Rekha Krishnaraj vs. ITO* [2013] 33 taxmann.com 64 (Karnataka)]

SLP against aforesaid order was dismissed on ground of delay in filing appeal [*Smt. Rekha Krishnaraj vs. ITO* [2017] 85 taxmann.com 256 (SC)

10.16 The assessee received share capital from various contributors. In course of assessment, Assessing Officer found various discrepancies in dates and amounts of contributions vis-à-vis statements recorded from contributors and details furnished by assessee. It was further noted that contributors to share capital were persons of insignificant means and their creditworthiness to have made contributions had not been established. Since the assessee failed to establish genuineness of cash contributions as well as capacity of persons to have made such contributions, addition under Section 68 is justified. [*B.R. Petrochem (P.) Ltd. vs. ITO* [2017] 81 taxmann.com 424 (Madras)

10.17 It is the settled legal position that peak credit is not applicable where deposits remain unexplained under Section 68 of the Act. The premise underlying the concept of peak credit is the squaring up of the deposits in the account with the corresponding payments out of the account to the same person. [*CIT vs. D.K. Garg* [2017] 84 taxmann.com 257 (Delhi).

CHAPTER

18

Benami Transactions & PBPT ACT

1. INTRODUCTION

1.1 What is a Benami Transaction

The Persian word 'Banām' (literally 'in the name of') is the etymological source of the term 'Benami', which itself means 'without name'. In common parlance, a benami transaction is one which is entered into by a person either under a fictitious name or in the name of a third party. In a benami transaction there is no intention of transferring any beneficial interest to the ostensible owner, who merely represents the real owner and holds the property or even business in trust for him. The real owner is the 'beneficial owner' and the ostensible owner is a 'benamidar'.

Benami transactions were a recognised specie of legal transactions in India especially in cases involving immovable properties. The erstwhile Section 82 of the Indian Trusts Act, 1882 is a case in point. In earlier days, it was legal right of the real owner to contend that even though the transfer of the property had been undertaken in the name of benamidar, the consideration has come from the real owner and, therefore, the benamidar was bound to restore such property to the real owner, as the case maybe. If the benamidar took a defiant attitude then the law used to provide a substantive right to the real owner to approach the Courts for getting an appropriate declaration and relief. Various Courts in India have entertained and decreed such suits for nearly a century.

The Supreme Court of India, under the old law, in the case of '*Thakur Bhim Singh (Dead)* by *LRs and Anr. vs. Thakur Kan Singh*' (1980) 3 SCC 72 had noted as under:

Two kinds of 'benami' transactions were generally recognised in India:

- One where a person buys a property with his own money but in the name of another person without any intention to benefit such other person. This transaction is called benami. In such case, the transferee holds the property for the benefit of the person who has contributed the purchase money, and he is the real owner.
- The second case which is loosely termed as a benami transaction is a case where a

person who is the owner of the property executes a conveyance in favour of another without the intention of transferring the title to the property thereunder. In this case, the transferor continues to be the real owner.

The difference between the two kinds of benami transactions referred to above lies in the fact that whereas in the former case, there is an operative transfer from the transferor to the transferee though the transferee holds the property for the benefit of the person who has contributed the purchase money, in the latter case, there is no operative transfer at all and the title rests with the transferor notwithstanding the execution of the conveyance. One common feature, however, in both these cases is that the real title is divorced from the ostensible title and they are vested in different persons. The question whether a transaction is a benami transaction or not mainly depends upon the intention of the person who has contributed the purchase money in the former case and upon the intention of the person who has executed the conveyance in the latter case.

1.2 Why Benami Transactions were Required to be Prohibited

Over time, the Legislature recognised the fact that benami transactions are often resorted for unlawful purposes and questionable objectives e.g.:

- To commit fraud on Creditors,
- To evade taxes,
- To evade the restrictions of the various agricultural and urban Land Ceiling Acts,
- To avoid certain political and social risks,
- To conceal black money obtained through corrupt practices etc.

Several attempts were made in the past to restrict the unlawful usage of such transactions e.g. Section 66 of Civil Procedure Code, 1908; Section 281A of Income-tax Act, 1961; Section 422–424 of Indian Penal Code, 1860 etc. but they were not deterrent enough. Since many benami transactions were found to stem from a desire to evade taxes, the Select Committee of the Parliament, while considering the Taxation Laws (Amendment) Bill, 1969, made specific observations in this regard. As a result, the Government made a reference to the Law Commission in 1969 to examine the possibility of prohibiting the practice of benami transactions.

2. STATUTORY MEASURES TO CONTROL BENAMI

In order to appreciate the present law, it is necessary for the officers to be fully aware of the past legislative efforts in this field as this shall enable them to have a clearer perspective and also help in conducting proper inquiries. The 57th Report of the Law Commission dated August 7th 1973 is the first detailed study in this context. The Law Commission had recommended drafting of a separate law. This led to the promulgation of the Benami Transaction (Prohibition of Right to Recover Property) Ordinance, 1988 on May 19th 1988, which barred giving of any recognition to benami transactions as well as provided a bar to raising of any defence on the grounds of benami. This Ordinance was followed by the Benami Transaction (Prohibition) Act, 1988, which prohibits benami transactions and bars any right to recover property held benami and for matters connected therewith or incidental thereto.

2.1 Benami Transactions (Prohibition) Act, 1988

Initially and after the promulgation of the Benami Transaction (Prohibition of Right to Recover Property) Ordinance, 1988, the Government had again referred the matter to the Law Commission for a detailed examination and for its considered views. The 130th Law Commission Report noted that with removal of Article 19(1)(f) & 31 of the Constitution, the right to property is no longer a fundamental right but is only a legal

right under Article 300A. The Law Commission Report mentions that India is a socialist state and observed that Benami transactions in all forms of properties like immovable, movable, intangibles etc. have contributed to thwarting of the tax laws, violation of social morality and concentration of wealth in few hands. The Commission accordingly made its recommendations and, after various deliberations, the Benami Transactions (Prohibition) Act, 1988 was passed on September 5, 1988 (The Act deems that Sections 3,5 & 8 have come into force with the passing of the Act and the remaining Sections were deemed to have come into force on May 19th 1988 itself).

The Benami Transactions (Prohibition) Act, 1988 defined Benami transaction as "any transaction in which the property is transferred to one person for a consideration paid or provided by another person". It also defined 'property' to mean property of every kind, whether movable or immovable, tangible or intangible, and includes any right or interest in such property. The Benami Transactions (Prohibition) Act, 1988 prohibited entering into any benami transaction in general and made it a non-cognizable and bailable offence. It also prescribed imprisonment and fines. The purchase of property by any person in the name of his wife or unmarried daughter for their benefit was, however, excluded from the definition of benami transaction. The Act of 1988 mandated that no suit, claim or action to enforce any right in respect of the benami property shall lie against the benamidar or any other person by or on behalf of the person claiming to be the real owner. Likewise, it also prohibited any defence based on any right in respect of the benami property. The Act also permitted acquisition of the benami properties by the prescribed authority.

However, the Act had some shortcomings, as mentioned below:

a. The definition of 'benami transactions' was quite narrow and not very clear.
b. The relevant Rules for carrying out the purposes of the Act were never notified.
c. The Implementing Authorities were not specified.
d. It did not contain any specific provision for vesting of confiscated property with the Central Government.
e. It did not have any provision for an Appellate Mechanism against an action taken by the authorities under the Act, while barring the jurisdiction of a Civil Court.
f. It did not confer the powers of the Civil Court upon the authorities for its implementation.

2.2 The Benami Transactions (Prohibition) Bill, 2011

The shortcomings of the earlier statute led to the drafting of a new legislation in place of the Benami Transaction (Prohibition) Act, 1988 in order to prohibit holding of property as benami, to restrict right to recover or transfer property held as benami and also to provide a mechanism and procedure for confiscation of property held benami. The Benami Transactions (Prohibition) Bill, 2011 was accordingly introduced in the Lok Sabha in July 2011 but the same could not be passed and it lapsed with the dissolution of the 15th Lok Sabha.

2.3 Benami Transactions (Prohibition) Amendment Bill, 2015

The infirmities and lacunae in the previous Act led to work on a comprehensive legislation and, as a result, the Benami Transactions (Amendment) Bill 2015, was introduced in the Parliament to amend the Act of 1988. By introducing only an amendment bill, the Legislature has taken a conscious decision to amend the old statute itself instead of bringing in a new statute. The reason behind amending the Act instead of repealing it, was to include all the benami transactions under

its ambit on which no action was taken under the 1988 Act, so that consequential action could follow. The amended Act has 72 Sections instead of the 9 Sections earlier. There are separate provisions identifying the authority to implement the Act specifying their functions and powers. The amendment has introduced the concepts of adjudication, attachment and confiscation of the benami properties. The amendment has introduced prosecution provisions and where any person enters into a benami transaction in order to defeat the provisions of any law or to avoid payment of statutory dues or to avoid payment to creditors, the beneficial owner, benamidar and any other person who abets or induces any person to enter into the benami transaction, shall henceforth be guilty of the offence of benami transaction. The amendment has also renamed the old statute as the Prohibition of Benami Property Transactions Act, 1988.

2.4 Prohibition of Benami Property Transactions Act, 1988

The Benami Transactions (Prohibition) Amendment Bill, 2015 received the Presidential assent on 10th August 2016. The Rules and all the provisions of the renamed Prohibition of Benami Property Transactions Act, 1988 (hereinafter referred to as PBPT Act, 1988) have come into force on 1stNovember, 2016. The Central Board of Direct Taxes has been entrusted to administer the Act.

2.5 Present Definition of Benami Transaction

In the PBPT Act, 1988, four types of benami transactions have been specified. These are explained in para 2.5.1 and 2.5.2 below.

2.5.1 As Per Section 2(9)(A) of PBPT, a Benami Transaction Means

(A) A transaction or an arrangement:

a. Where a property is transferred to, or is held by, a person, and the consideration for such property has been provided, or paid by, another person; and

b. The property is held for the immediate or future benefit, direct or indirect, of the person who has provided the consideration.

However, the above definition excludes cases where the property is held by:

i. A Karta, or a member of a Hindu undivided family, as the case may be, and the property is held for his benefit or benefit of other members in the family and the consideration for such property has been provided or paid out of the known sources of the Hindu undivided family;

ii. A person standing in a fiduciary capacity for the benefit of another person towards whom he stands in such capacity and includes a trustee, executor, partner, director of a company, a depository or a participant as an agent of a depository under the Depositories Act, 1996 and any other person as may be notified by the Central Government for this purpose;

iii. Any person being an individual in the name of his spouse or in the name of any child of such individual and the consideration for such property has been provided or paid out of the known sources of the individual;

iv. Any person in the name of his brother or sister or lineal ascendant or descendant, where the names of brother or sister or lineal ascendant or descendant and the individual appear as joint-owners in any document, and the consideration for such property has been provided or paid out of the known sources of the individual; or

It is apparent that for any property to be held as benami both the above conditions at (a) and (b) are to be satisfied. While the first condition of the above definition is relatively easy to investigate, the second condition concerning benefit is bound to be contentious. Many judicial decisions

have laid down certain directions for the same. The 'accruing of benefit' has to be gauged from various parameters and case laws. In the case of *Jaydalal Poddar (Deceased) vs. Mst Bibi Hazra AIR* 1974 SC 171, it had been held that though the question, whether a particular sale is Benami or not, is largely one of fact, and for determining this question no absolute formulae or acid tests uniformly applicable in all situations can be laid down, yet in weighing the probabilities and for gathering the relevant indicia the courts are usually guided by these circumstances:

i. The source from which 'the purchase money came;

ii. The nature and possession of the property, after the purchase;

iii. Motive, if any, for giving the transaction a benami color;

iv. The position of the parties and the relationship, if any between the parties;

v. The custody of the title-deeds after the sale, and

vi. The conduct of the parties concerned in dealing with the property after the sale.

The above decision has been cited with approval by the Supreme Court in a recent decision in the case of *Om Prakash Sharma vs. Rajendra Prasad Shewda* in Civil Appeal No. 8609–8610 OF 2009 decided on 9th October, 2015.

It is also to be noted that the parameters above are not exhaustive and all these surrounding circumstances would require to be taken into consideration for determining the nature of a transaction.

It is also necessary to note that the terms 'transaction or an arrangement' would also include a concerted action or a device.

2.5.2 As per subsequent provisions of Section 2(9)(B), 2(9)(C) and 2(9)(D) of PBPT, a benami transaction also means:

(B) a transaction or an arrangement in respect of a property carried out or made in a fictitious name; or

(C) a transaction or an arrangement in respect of a property where the owner of the property is not aware of, or, denies knowledge of, such ownership;

(D) a transaction or an arrangement in respect of a property where the person providing the consideration is not traceable or is fictitious.

2.5.3 The Explanation given below the definition under Section 2(9) of PBPT excludes the transactions covered under Section 53A of the Transfer of Property Act,1882 from the purview of PBPT Act, 1988. It has been clarified that the benami transaction shall not include any transaction involving the allowing of possession of any property to be taken or retained in part performance of a contract referred to in Section 53A of the Transfer of Property Act, 1882, if, under any law for the time being in force:

i. Consideration for such property has been provided by the person to whom possession of property has been allowed but the person who has granted possession thereof continues to hold ownership of such property;

ii. Stamp duty on such transaction or arrangement has been paid; and

iii. The contract has been registered.

An important aspect to be kept in mind would be that even in above exceptions, the consideration paid has to come from known sources. In fact, at the time of its introduction the Benami Transactions (Prohibition) Amendment Bill, 2015 the relevant phrase read as "known sources of income". However, the words "of income" were removed since the Government felt that the consideration may come from any source e.g. loans from banks, contribution by family members etc. which may not necessarily be the

income of the person paying the consideration. This is another point to be kept in mind while investigating the source of the consideration paid.

2.6 Examples of Benami Transactions

Some of the likely examples of Benami Transactions in light of the new definition could be as under:

a. Transactions carried out in fictitious names: Purchasing a property using fake Aadhar, Passport, PAN etc.

b. Cases where the ostensible Owner of the property is not aware of or denies knowledge of such ownership: The Government has introduced the 'Jan Dhan Account Scheme' to bring the unorganized sector under the ambit of banking. However, the same was misused by some unscrupulous persons during 'demonetization' process to deposit cash into such accounts. Here, the owner of these accounts may not be aware of such transactions or they may accept that they are not real owners of these moneys. These are simple benami transactions. Similarly, assets found or seized in Search & Seizure operations, where the same is declared to be pertaining to third persons, may be a case of Benami transaction if the third person denies the same.

c. Where person providing the consideration is not traceable or is fictitious. For example, cash is found in the hands of a person, who denies ownership of such cash, while at the same time, is not in a position to explain the source of the cash. This can be a case of benami transaction.

2.7 Definition of the Term 'Property' and 'Benami Property' as per PBPT Act, 1988

The amended PBPT Act, 1988 has made the definition of the term 'property' very comprehensive. As per Section 2(26) of PBPT Act, 1988, 'property' means *"assets of any kind, whether movable or immovable, tangible or intangible, corporeal or incorporeal and includes any right or interest or legal documents or instruments evidencing title to or interest in the property and where the property is capable of conversion into some other form, then the property in the converted form and also includes the proceeds from the property"*.

Section 2(8) of the Act defines Benami Property. As per this *"benami property means any property which is the subject matter of a benami Transaction and also includes the proceeds from such property"*.

The last Clauses in both the above definitions are pertinent. The PBPT Act, 1988 can now legally pursue the proceeds from the Benami Property. Though the term 'proceeds' has not been defined, the officers can take guidance from the definition of the term 'proceeds of crime' given in Section 2(u) of the Prevention of Money Laundering Act, 2002.

The definition of property has been made very wide and the term includes assets of every kind. The officers are required to acquaint themselves with the various definitions of the term 'property' (movable or immovable) contained in the General Clauses Act 1897; Transfer of Property Act 1882; Registration Act 1908; Indian Penal Code 1860; Sale of Goods Act 1930 etc. A few examples of 'Property' from the point of investigation of benami transactions would include:

- FDRs, Cash, Financial Instruments, Vehicles, Machinery, Jewellery, Loans, Debts, Bank deposits, Bank lockers and Private lockers, Investment in Mutual funds, Demat accounts, Savings in Co-op Banks and Co-op societies, crypto currencies etc.

- Right of worship, royalty, patent, copyright, trademarks, design, benefit arising out of land, right of way, fisheries etc.
- Assets/ properties held in the name of persons having no or meager income and no PAN cases.
- House, Flat, Land or Other Immoveable Property acquired or transferred in the names of drivers/ servants/ poor relatives.
- Stock-in-trade or other goods kept in warehouses/ cold storage under fictitious names etc.

2.8 Other Important Definitions under the PBPT ACT, 1988

a. Person: Section 2(24) of the Act defines that "person" shall include:

i. An individual;

ii. A Hindu undivided family;

iii. A company;

iv. A firm;

v. An association of persons or a body of individuals, whether incorporated or not;

vi. Every artificial juridical person, not falling under sub-Clauses (i) to (v)

b. Benamidar: Section 2(10) of the Act defines that "Benamidar" means a person or a fictitious person, as the case may be, in whose name the benami property is transferred or held and includes a person who lends his name.

c. Beneficial Owner: Section 2(12) of the Act defines that "beneficial owner" means a person, whether his identity is known or not, for whose benefit the Benami property is held by a benamidar.

2.9 Other Provisions of PBPT Act, 1988

Other relevant features of PBPT include the provisions declaring the Authorities under the PBPT Act, 1988 i.e. the Initiating Officer, the Approving Authority, the Administrator and the Adjudicating authority. The Act also defines their respective jurisdiction and powers. They have also been given the same powers as are vested in a Civil Court under the Code of Civil Procedure, 1908, while trying a suit in respect of certain matters, similar to what an Income-tax Authority possesses *u/s* 131 of the Income-tax Act. The PBPT Act, 1988 also mentions that the authorities appointed under Section 117 of the Income-tax Act, 1961 shall assist the authorities under PBPT Act, 1988. It also mentions other Governmental authorities who are also required to render assistance to the officers implementing the PBPT Act, 1988. The PBPT Act, 1988 has provisions for attachment, adjudication and confiscation of the benami property. It also has provisions for setting up Appellate Tribunals and Special Courts to settle disputes.

The following 'authorities' are specified in the PBPT Act, 1988:

i. **Initiating Officer:** means an Assistant Commissioner or a Deputy Commissioner as defined in Clauses (9A) and (19A) respectively of Section 2 of the Income-tax Act, 1961 (hereinafter referred to as the 'IO')

ii. **Approving Authority**: means an Additional Commissioner or a Joint Commissioner as defined in Clauses (1C) and (28C) respectively of Section 2 of the Income-tax Act, 1961 (hereinafter referred to as the 'AA')

iii. **Administrator:** means an Income-tax Officer as defined in Clause (25) of Section 2 of the Income-tax Act, 1961

iv. **Adjudicating Authority:** means the Adjudicating Authority appointed under Section 7 of the PBPT Act, 1988.

v. **Appellate Authority:** means the Appellate Tribunal established under Section 30 of the PBPT Act, 1988.

As per CBDT Notification No. 97/ 2016-Income-tax New Delhi, dated 25th October, 2016, it has been mentioned that with effect from the 1st day of November, 2016, the Adjudicating Authority appointed under sub-Section (1) of Section 6 of the Prevention of Money-Laundering Act, 2002 (15 of 2003) and the Appellate Tribunal established under Section 25 of that Act shall discharge the functions of the Adjudicating Authority and Appellate Tribunal, respectively, under the Prohibition of Benami Property Transactions Act, 1988 (45 of 1988) until the Adjudicating Authorities are appointed and the Appellate Tribunal is established under the Prohibition of Benami Property Transactions Act, 1988.

2.10 Other Legal Implications

The PBPT Act also has few other implications, having a far-reaching effect, as under:

- No benamidar can re-transfer the benami property to the beneficial owner or to any other person acting on his behalf. Such transfer shall be null and void.
- No suit, claim or action to enforce any right in respect of any property held benami against the person in whose name the property is held or against any other person shall lie by or on behalf of a person claiming to be the real owner of such property.
- No defence based on any right in respect of any property held benami, whether against the person in whose name the property is held or against any other person, shall be allowed in any suit, claim or action by or on behalf of a person claiming to be the real owner of such property.
- Any property, which is subjectmatter of benamitransaction, shall be liable to be confiscated by the Central Government and no compensation shall be payable in respect of such confiscation.
- The offences under the PBPT Act are now liable to prosecution with prior approval of CBDT. Along with the beneficial owner, the benamidar and any other abettor can also be prosecuted and sentenced to rigorous imprisonment ranging from one to seven years, besides being liable for paying a fine.

3. INCOME-TAX AUTHORITIES AND RELEVANT NOTIFICATIONS UNDER PBPT

The Department of Revenue has notified the Prohibition of Benami Property Transactions Rules, 2016 vide its Notification No. 99/ 2016/ F. No. 149/ 144/ 2015-TPL (Part-II) dated 25th October, 2016. Certain functions have been assigned to CBDT as per Section 48 (Educational Qualification of Representatives) and *u/s* 55 (Giving approval for prosecution as provided *u/s* 3, 53 and 54).

The CBDT has issued Instructions vide F. No. 414/ 21/ 2017-IT (Inv. I) dated April 5th 2017 regarding creation of dedicated setup for implementation of the PBPT Act 1988 and has directed setting up of 'Benami Prohibition Units' (BPU) across the country.

The CBDT vide Notification No. S.O. 1621(E) dated 18th May 2017 has specified the Income-tax Authorities across the country who are authorised to exercise the powers and perform the functions under PBPT Act, 1988 and has also specified their Headquarters and Territorial Area.

The CBDT has also issued a Standard Operating Procedure with regard to the implementation of Prohibition of Benami Property Transactions Act, 1988 vide F. No. 414/ 63/ 2016-IT (Inv. I) dated 10th August 2017.A total of 24 'Benami Prohibition Units' are setup in the administrative charge of a Pr. DIT (Inv.)/ DIT(Inv.). This SOP explains the duties and functions of the BPU. It is to be noted that though the Initiating Officers

and Approving Authorities have been placed under the administrative control of respective DIT (Investigation)/ DGIT (Investigation), the DIT (Inv)/ DGIT (Inv) are not the authorities under PBPT Act. They do not have any statutory role in the administration of this Act.

The CBDT has also issued an Order issued in S.O. 5194(E) dated 9th October 2018 titled the 'Prohibition of Benami Property Transactions (Removal of Difficulties) Order, 2018',which seeks to amend the PBPT Act, 1988 to permit the Initiating Officer to take the assistance of an authorised representative.

The Department of Revenue has vide its Notification No. S.O. 5323(E) dated 16th October 2018 has designated various Courts of Session in the country for the purposes of the trial of offences punishable under the PBPT Act, 1988.

The CBDT has also initiated the 'Benami Transactions Informants Reward Scheme, 2018' vide F. NO. 299/ 31/ 2017-Dir (Inv. III) 22 dated 23rd April 2018. The CBDT has also issued Guidelines for Departmental Officers for dealing with information received under this reward scheme vide F. No. 299/ 31/ 2017/ Dir (Inv. III) 21 dated 23rd April 2018.

The above notifications, guidelines, instructions and letters should be carefully gone through.

4. RESPONSIBILITIES AND DUTIES OF OFFICERS OF BPU

a. It is important to understand that the work of the benami unit is entirely different from the normal assessment/ investigation work in the Income-tax department. The benami unit (Approving Authority, Initiating Officer and Administrator) do not have a basic document like Income-tax return and there is no concept of issuing a notice like 143(2) of Income-tax Act. The manner of functioning of Benami unit is described in following paragraphs in order to provide an insight.

b. The benami unit may get information from different Government agencies including Income-tax Department officers about suspected benami transactions/ property. Also, the information may flow from private persons or private organisations. As an authority implementing one of the stringent laws of the country, the IO should demonstrate a flair for gathering information. He should be alert to the market information, ongoing/ past investigations done by various agencies, newspaper articles, to name a few. Further he would do better if he is able to garner information from the vernacular press. The IO can also obtain credible information from 'informants' and, in any case, he is empowered under Section 20 of PBPT Act 1988 to obtain necessary assistance from various authorities *viz.* Income-tax, FIU, Customs& Central Excise, NCB, Stock Exchanges, Police, RBI, SEBI etc. concerning information which may be useful in deciding whether a transaction is Benami or not. The IO can also take the assistance from an officer of any other body corporate constituted or established under a Central or State Act. The IO can also take assistance of such other officers of the Central Government, State Government, Local Authorities, or Banking Companies as may be notified in this behalf. A few instances of the assistance required can be:

- Obtaining incriminating documents including title deeds and details of assets found during Search and Seizure Action.
- Obtaining details of seizure of Gold, Foreign currencies and other items by Customs.
- Obtaining details of seizure of drugs and other items by NCB/ Police

- Obtaining details of Fictitious Transactions emerging from the investigation carried out by various government agencies.
- Obtaining relevant F.I.R and other crime reports from Police/ ED
- Obtaining relevant Revenue records of the State Government

c. After the receipt of information, the IO is personally required to evaluate the same in order to form a preliminary view as to whether the information relates to benami property transaction or not. In essence the processing of information entails that whenever an information is received from any source, the IO shall examine it to ascertain whether there is a *prima facie* ground to initiate any inquiry. If he is not satisfied with the material, he can call for more information from the source(s). Once the IO is satisfied that the available material is *prima facie* substantial and significant to initiate an inquiry/ investigation in respect of any person, place, property, assets, books of accounts, documents etc. he shall obtain the approval from the Adjudicating Authority (the AA) *u/s* 23 of the Act for conducting the necessary inquiry or investigation. The IO can issue summons for discovery and inspection; enforce attendance of any person and record statements on oath;

d. If on the basis of the material in his possession, the IO has reasons to believe that any person is a benamidar in respect of a property, he is first required to record reasons in writing before issuing a showcause notice to the benamidar(s) *u/s* 24(1) of PBPT Act, 1988. This action is akin to recording of reasons *u/s* 148 of Income-tax Act, 1961. The independent satisfaction of the IO has to discernible from the reasons recorded. A copy of the showcause notice is to be served on the beneficial owner also, if his identity is known. In view of the extant law on reopening of assessments and recording of satisfaction, it would be proper that the showcause notice should contain proper reasons and complete available with the IO for treating the transaction as benami transaction. Further it would be better if the showcause notice encloses the copies of documents/ copies of statements etc. relied on by the IO. For the purposes of natural justice, the showcause may also indicate the following, as the case may be:

   i. The relevant Clause of Section 2(9) of the Act under which the satisfaction is drawn.
   ii. Reasons available with the IO for considering the person as a benamidar, if relevant.
   iii. Alleged relationship between benamidar and Benami property.
   iv. The identity of the Beneficial Owner, if any.
   v. The relevant documents and copies of the statements recorded and proposed to be Utilised against the person.

e. The showcause should give a reasonable period for making proper representation, preferably 15 days from the date of notice issued. It must also be kept in mind that the proceedings *u/s* 24 of the PBPT Act, 1988 has an outer time limit of 90 days only. The officers should be careful in preparing the showcause notice. For issuing this notice, no approval of AA is legally required. If the IO is of opinion that the impugned property is likely to be alienated by the person having possession of the same, an interim provisional attachment may be made by the IO with the approval of AA by way of passing an order *u/s* 24(3)

at any time after the issue of show-cause notice. This interim provisional attachment can be made for the period upto the date of passing of the order by the Adjudicating Authority. The service of the notice and attachment order is of crucial importance. The Section 25 of the PBPT Act 1988 mandates that the notice may be served on the person named therein either by post or as if it were a summons issued by a Court under the Code of Civil Procedure, 1908 only. The notice has to be addressed correctly as specified.

f. With the issue of show cause notice, the clock starts ticking as the final order *u/s* 24(4) has to be passed with the prior approval of AA within 90 days. The final order of the IO can culminate into either a continual of the earlier provisional attachment or a provisional attachment of the property. The provisional attachment of the property has to be done in the manner provided in the Second Schedule of the Income-tax Act, 1961.

g. In the showcause notice issued and served on the benamidar and beneficiary, the IO should indicate the date and time for hearing to the benamidar and to the beneficiary. The benamidar/ beneficiary may choose to avail of opportunity of being heard and or may file their replies to the show cause notice. After hearing and or after going through the replies filed, if any, the IO may make further inquiries/ investigation if required and then pass the order *u/s* 24(4). The order should be served on the benamidar and beneficiary. The copy of order should also be served on the person who might be having control of the property attached.

h. The proceedings under Section 24 can be closed only with the approval of the Approving Authority. Therefore, an independent application of mind of the Approving Authority is required with appropriate recording of reasons so that the order passes the test of judicial scrutiny. The Approving Authority shall pass a speaking order clearly spelling out as to why he is approving the proposal of IO, either to proceed further or to close the matter.

i. Unlike an assessment/ penalty order under Income-tax Act, the order *u/s* 24(4) does not create any demand on the benamidar, beneficiary and/ or any person who might be having control of the property. Also, unlike the Income-tax proceedings, there is no regular appeal provided against the order *u/s* 24(4). Instead, the IO is required to draw a statement of the case and refer it to the Adjudicating Authority within 15 days from the date of order *u/s* 24(4). This statement must have copies of documents relied upon by the IO while passing the order *u/s* 24(4). On receipt of the reference, the Adjudicating Authority shall issue notices to the specified benamidar, the beneficial owner, any interested party, any person making a claim in respect of the property and shall direct them to furnish such documents, particulars or evidence as is necessary. A copy of the Statement of the case along with the relied upon documents may be served on each benamidar and each beneficiary as per the directions of Adjudicating Authority. Therefore, the IO should make sufficient copies of the reference and relied upon documents.

j. The Adjudicating Authority is required to provide an opportunity of being heard to the concerned parties as well as to the IO. The Adjudicating Authority is also required to give opportunity of being heard to any other person/ organisation who might

have interest in the attached property. Fresh documents can be filed at this stage. After hearing the different parties and after examining the documents, the Adjudicating Authority has to pass an order within one year of the end of the month in which the statement of the case was received by it. In its order the Adjudicating Authority can either confirm the attachment order or revoking the same. In the course of the proceedings before it, the Adjudicating Authority can provisionally attach any other benami property also even if the same was not referred to it. The Adjudicating Authority can amend the names of the parties to the dispute, as the case may be. If any property is held to be benami, the Adjudicating Authority shall, after giving an opportunity of being heard to the other person, make an order to confiscate the property.

k. After the Adjudicating Authority passes an order of confiscation of the property, the Administrator shall have the power to receive and manage the property. The Administrator shall give a notice in writing of seven days to any person, who may be in possession of the benami property, to surrender or deliver possession thereof to the Administrator or any other personduly authorised in writing by him in this behalf. In the event of non-compliance of the order or for the purpose of forcibly taking over the property, the Administrator can requisition the service of any police officer to assist him and it shall be the duty of the officer to comply with the requisition. The Administrator shall also take such measures, as the Central Government may direct, to dispose of the property which is vested in the Central Government under sub-Section (3) of Section 27, in such manner and subject to such conditions as may be prescribed. The Authorised officer shall forthwith issue notice to the authority of the Central Government or a State Government, as case may be, having jurisdiction for the purposes of registration of such immovable property, intimating about the confiscation of the property. He is also required to arrange to place a copy of the notice at some conspicuous part of the immovable property for the benefit of general public mentioning clearly therein, in English and in vernacular language, that the property has been confiscated under the Act and vests absolutely in the Central Government. He is also required to arrange to make a proclamation for the confiscation of immovable property at some place on or near such property by beat of drum or other customary mode. He is also required to forthwith issue a notice to the authority or person having the custody of such movable property informing him about the confiscation of such property. He is also required to sell the property, if the property is liable to speedy and natural decay or the expenses for maintenance is likely to exceed its value, with the leave of the concerned Adjudicating Authority, and deposit the sale proceeds in the nearest Government Treasury or branch of the State Bank of India or its subsidiaries or in any nationalised bank in fixed deposit and retain the receipt thereof. The relevant rules in this behalf are required to be kept in mind.

l. The Adjudicating Authority can also issue notice and attach any other property although the IO may not have attached the same.

m. Any party aggrieved by the order of Adjudicating Authority can file appeal before Appellate Tribunal. Further appeal against the order of Appellate Tribunal is provided before the respective High Court. No appeal to Supreme Court is provided.

n. Prosecutions can be launched only in designated Special Courts. The Central Government, in consultation with the Chief Justice of the High Court, shall, designate one or more Courts of Session as Special Court or Special Courts in this regard.

4.1 Role of Investigation

It should also be kept in mind that the concept of holding a property as benami is a conscious decision. While any decision to declare or conceal income is generally taken after the transactions have been completed, the decision to enter into a benami transaction is taken after careful deliberations and is taken much before entering into a benami transaction. Therefore, the Inquiries and investigations required have to be thorough and much deeper in order to establish benami nature of such transactions. The BPU should note that entire spectrum of attachment proceedings, confiscation proceedings, prosecution proceedings etc. depend on the inquiries and investigations carried out by the benami unit. The inquiries/ investigations do not mean merely issuing notices to the benamidar and beneficiary or just recording their statements. It involves a much larger area of investigation and lots of facts have to be ascertained to pass the tests laid down by Hon'ble Supreme Court and in order to survive the litigation at different levels. A point to be kept in mind is that the right to property is still a legal right and no person can be divorced from his property except with the due process of law.

5. INVESTIGATION BY INITIATING OFFICER

The IO should note the new definition of benami transactions and the broadened scope of the term 'property'. The IO has to first get into the source of the consideration paid and has to establish whether the same is out of known sources or not. There is a likelihood of the relevant transaction being camouflaged and hidden under layers, with money getting transferred through various accounts. The IO has to make all possible inquiries to get to the ultimate source of the money. Mere suspicion is not enough.

Further in addition to source, the IO has to look at the overall circumstances surrounding the transactions also. If the transaction is one which is exempted by the PBPT Act, then also it would be necessary to ascertain the source of the consideration.

The IO has to establish the benami nature of the transaction with strong evidences. It has to be proved that some person, other than owner, is enjoying the benefits of the property. If say, a wealthy businessman, out of his unaccounted money, buys a property in the name of some other person. In reality, he is using the property. Here, the IO should inquire into the financial capacity of the other person-the benamidar. On further inquiry into his financials, it will certainly be found out that the businessman has introduced money into this other person's books to purchase the said property. After establishing the source, the IO should do field inquiries, such as who is actually using the property. The IO may ask the neighbors, take statements of servants working at the property, ask local vendors/ service providers about the beneficiaries etc. The IO may also go into details of house tax, electricity, phone bills etc. to find out who is paying for the same. All these facts shall help establish the beneficial owner of the property.

In cases of introduction of bogus share capital, a likely query can arise as to whether the assets acquired by such Company can constitute benami property under the Act. Typically, the taking of an accommodation entry involves bringing one's unaccounted income into books as loans, advances, introduction of share capital etc. If an individual, having unaccounted income, routes this money into one of the companies owned/ controlled by him/ her in the form of share capital, the money can also

be used to buy assets in the name of company. In this situation, if upon an inquiry it is found out that the ultimate source of share capital is the unaccounted income of a third person, then the assets purchased by the company out of the bogus share capital will represent a Benami Property. Theostensible shareholders/ company are the benamidars while the real owner of the money is the beneficial owner.

However, without prejudice to above, it is expected that the IO should be able to differentiate between a Sham transaction and Benami transaction. For example, 'A' transfers his property on paper to 'B', though for all practical purposes, the real ownership of the property remains with 'A'. Here one has to look at the consideration angle. Usually this is done in case of family disputes, to relieve oneself of all properties so that they need not be shared with the other litigants. In such cases, normally there may be no actual consideration paid by 'B' to 'A'. This is a sham transaction and technically this may not be considered as a Benami Transaction.

5.1 To sum up, broadly the following points should be kept in mind while investigating a case of benami property:

- The first point of suspicion: Person in possession of the property does not have the financial capability to own/ hold it. Though at times, even a person with sufficient means can also act as a benamidar. Hence, this step is the beginning of the investigation and is not the final conclusion.
- Identifying the source from where the money for purchase was received and analysing the movement of funds. This may involve ignoring the facade of the transaction and sifting through the layers of transactions/ entities to ascertain the true source of money.
- Collecting PAN of benamidar and beneficial owner, if possible.
- Identifying the property clearly as to its location, title and all the papers related to it.
- Identifying the real intention of the beneficial owner to own the property through someone else.
- Identifying the persons who helped in carrying out the benamitransaction. As per new amendments to the PBPT Act,1988 even these persons are guilty for abetting the crime.
- If it is an immovable property- identify who is maintaining it and paying for the utilities like rent, electricity, water bills, property tax payments, telephone bill and such other statutory payments. Even if it is done by the benamidar, what is ultimate source of these payments?
- Another important point to be noted by IO is that the *burden of proof in case of Benami transactions always lies on the person who alleges a transaction to be a Benami Transaction.* Hence, here it is the duty of the IO to prove with enough evidence that the particular transaction is a Benami Transaction.

5.2 Case Studies of Recent Inquiries in Field

i. One assessee's farm house was actually attached under Prohibition of Benami Transaction Act, 1988 recently. The assessee wanted to construct a farm house in a rural area. However, the law permits only a farmer to buy agricultural land in that area. Since the assessee was not a farmer, he formed a company whose purpose was declared to be farming. The father in law and the mother in law of the assessee were made Directors of the Company and land was purchased in the name of the Company and subsequently a farm house

was constructed. The assessee, in the form of unsecured loans, provided the money to the company to buy the land and to build the farm house. As per the PBPT Act, exemption is only for a property purchased in the name of one's wife or child and no other relative. This was definitely not the case here. In fact, the Company was not declaring any income from farming also. It was also found that the farm house was actually been used by the assessee only on a regular basis. Hence, after following the due process, the farm house was attached by the Benami Unit of the department.

ii. During one inquiry into the affairs of a Cooperative society/ Bank, many benami FDs were found. To avoid suspicion, these FDs had been deliberately kept in small denominations, i.e. below Rs. 50,000. However, when further inquiries were conducted and the statements of persons, in whose names these FDs were opened, were recorded it was found that the ostensible owners were not aware of such accounts being opened in their name in the cooperative bank. It was also seen that the due process of KYC documentation was also not completed by Bank in such cases. Thus, all these FDs were found to be benami properties.

iii. In one Search & Seizure Operation, the assessee was found to be in possession of certain vehicles. The keys of the vehicles and the original documents of the vehicles were also in possession of the assessee. However, the names mentioned on these documents were different. The persons, in whose names cars were purchased, were summoned and their statements were recorded. They denied any knowledge of such cars being purchased. Further, they did not have any financial capacity to purchase these cars. Inquiries were also made from the service Centres, who confirmed that it was only the assessee who would send the cars for servicing. The local building watchman also confirmed that cars were used by the assessee. These facts were confronted to the assessee and he accepted the same. All such cars were attached and treated as benami.

6. BASIC FUNDAMENTALS OF ADMINISTERING THE PBPT ACT, 1988

6.1 Burden of Proof

In legal jurisprudence and also as per the Indian Evidence Act, 1872, the burden of proof as to any particular fact lies on that person who wishes the Court to believe in its existence. In the proceedings under the PBPT Act 1988, the burden of proof is on the State i.e. an authority who administers the Act. The basis of placing the burden of proof on the authority does not emanate from the PBPT Act,1988; rather it originates from a number of court decisions. In the case of *Thakur Bhim Singh (Dead)* by *LRs and Anr. vs. Thakur Kan Singh (Supra)* the Supreme Court has observed as under:

"It is well settled that the burden of proving that a particular sale is benami and the apparent purchaser is not the real owner, always rests on the person asserting it to be so. This burden has to be strictly discharged by adducing legal evidence of a definite character which would either directly prove the fact of benami or establish circumstances unerringly and reasonably raising an inference of that fact. The essence of a benami is the intention of the party or parties concerned; and not often such intention is shrouded in a thick veil which cannot be easily pierced through. But such difficulties do not relieve the person asserting the transaction to be benami of any part of the serious onus that rests on him; nor justify the acceptance of mere conjectures or surmises, as a substitute for proof. The reason is that a deed is a solemn document prepared and

executed after considerable deliberation and the person expressly shown as the purchaser or transferee in the deed, starts with the initial presumption in his favour that the apparent state of affairs is the real state of affairs."

6.2 Standard of Proof

As the burden of proof is on the authority who administers the PBPT Act, it is imperative that standard of proof in the form of evidence has to be credible and cogent and such evidence should pass the test of admissibility under the Indian Evidence Act, 1872. There is no place for any presumption and inference while discharging the duty of proving the allegation that transaction is in the nature of Benami.

6.3 Principle of Natural Justice

As the burden of proof lies with the enforcing authority, proper opportunity of hearing and action without any bias have to be ensured both in letter and spirit and in accordance with procedures established by law. While implementing the provisions of the Act the authorities shall not be bounded by the Code of Procedure 1908, but by the principle of natural justice. Therefore, a notice or order should clearly spell out the facts and be in the nature of a well defined speaking order. It should also contain reference to all the relied upon documents, which should be open to scrutiny of the alleged person. This will ensure that the Act is not only bona fide but also fair in procedure.

CHAPTER

19

Examination of Witnesses

1.1 Under the provisions of Section 131 of the Income-tax Act, 1961; the Assessing Officer and other specified authorities have the powers of the Civil Court vested in them under the Code of the Civil Procedure, 1908 in respect of the matters enumerated in that Section. Enforcing the attendance of any person and examining him on oath is one of them. Sections 132 and 133A also give powers of recording statements to the authorities specified therein.

1.2 Relevant portion of Section 131 is as under:

"131. (1) The Assessing Officer, Deputy Commissioner (Appeals), Joint Commissioner, Commissioner (Appeals), Principal Chief Commissioner or Chief Commissioner or Principal Commissioner or Commissioner and the Dispute Resolution Panel referred to in Clause (a) of sub-Section (15) of Section 144C shall, for the purposes of this Act, have the same powers as are vested in a court under the Code of Civil Procedure, 1908 (5 of 1908), when trying a suit in respect of the following matters, namely:

(a)	discovery and inspection;
(b)	enforcing the attendance of any person, including any officer of a banking company and examining him on oath;
(c)	compelling the production of books of account and other documents; and
(d)	issuing commissions.

(1A) If the Principal Director General or Director General or Principal Director or Director or Joint Director or Assistant Director or Deputy Director, or the authorised officer referred to in sub-Section (1) of Section 132 before he takes action under Clauses (i) to (v) of that sub-Section, has reason to suspect that any income has been concealed, or is likely to be concealed, by any person or class of persons, within his jurisdiction, then, for the purposes of making any enquiry or investigation relating thereto, it shall be competent for him to exercise the powers conferred under sub-Section (1) on the income-tax authorities referred to in that sub-Section, notwithstanding that no proceedings with respect to such person or class of persons are pending before him or any other income-tax authority."

1.3 There are two distinct sub-Sections in Section 131, each with its precondition, under which the Income-tax Authorities have been given the power to issue summons. Section 131 of the Income-tax Act has been in operation since the introduction of the Income-tax Act. Under

Section 131(1), the power to issue summons has been given to the officers engaged in assessment/ appellate/ revision related functions during the pendency of Income-tax Proceedings. The words "for the purposes of this Act" in Section 131(1) are to be construed to mean that some proceedings must be pending before the aforesaid officers who can invoke these powers.

1.4 The limitations of issuing summons during the pendency of Income-tax proceedings were recognised and sub Section (1A) to Section 131 was introduced by the Taxations Laws (Amendment) Act, 1975 w.e.f. 01-10-1975. Section 131(1A) gives similar powers to the offers of the Investigation wing to summon without any proceedings pending before them, if they have reasons to suspect that the person concerned has concealed or likely to conceal the income.

1.5 The procedure for examination of witnesses, as far as possible, should be in accordance with the provisions of Order XVIII & Order XIX of the Civil Procedure Code, relevant extracts from which, are appended to this Chapter.

1.6 The relevant portion of Section 132(4) is as under:

"132(4) The authorised officer may, during the course of the search or seizure, examine on oath any person who is found to be in possession or control of any books of account, documents, money, bullion, jewellery or other valuable article or thing and any statement made by such person during such examination may thereafter be used in evidence in any proceeding under the Indian Income-tax Act, 1922 (11 of 1922), or under this Act."

1.7 The relevant portion of Section 133A is as under:

" 133A (3) An income-tax authority acting under this Section may,:

(iii)	record the statement of any person which may be useful for, or relevant to, any proceeding under this Act"

1.8 In Income-tax proceedings, the person giving statement could be either an assessee or a witness produced by assessee or requisitioned by the department. Persons interrogated could be the assessee or his employees or relatives or other people like creditors, debtors, contractors, agents, brokers and government or bank officials. It could as well as involve experts like engineers, architects, hand-writing expert etc. Examination should be a purposeful questioning of the person having knowledge of the transaction under investigation, so as to elicit true facts.

1.9 The examination is normally, in the form of questions and answers put to the deponent witness orally. The questions and its answers are taken down verbatim. In the end of the deposition, it is read out to the deponent and signed by him and the presiding officer.

1.10 As per Section 136 in the Income- tax Act,1961; any proceeding under the Income-tax Act before an income-tax authority shall be deemed to be a judicial proceeding within the meaning of Sections 193 and 228 and for the purposes of Section 196 of the Indian Penal Code, 1860 (45 of 1860) and every income-tax authority shall be deemed to be a Civil Court for the purposes of Section 195, but not for the purposes of Chapter XXVI of the Code of Criminal Procedure, 1973 (2 of 1974)].

2. RELEVANT PROVISIONS OF THE INDIAN EVIDENCE ACT, 1872

2.1 The law relating to examination of witness is contained in Section 135 to 166 of the Indian Evidence Act, 1872. These provisions may be referred to by the AOs before taking up cases of serious investigation.

2.2 As per Section 3 of the Indian Evidence Act, 1872; "Evidence" means and includes

1. All statements which the Court permits or requires to be made before it by witnesses, in relation to matters of fact under inquiry; such statements are called oral evidence;

2. All document including electronic records produced for the inspection of the Court, such statements are called documentary evidence.

2.3 As per Section 137 of the Indian Evidence Act, the examination of a witness by the party who calls him shall be called his examination in chief. The examination of a witness by the adverse party shall be called his cross-examination and the examination of a witness, subsequent to the cross-examination by the party who called him, shall be called his re-examination.

2.4 As per Section 138 of the Indian Evidence Act, witnesses shall be first examined-in-chief, then (if the adverse party so desires) cross-examined, then (if the party calling him so desires) re-examined. The examination and cross–examination must relate to relevant facts but the cross–examination need not be confined to the facts to which the witness testified on his examination–in-chief. The re-examination shall be directed to the explanation of matters referred to in cross-examination; and, if new matter is, by permission of the Court, introduced in-re-examination, the adverse party may further cross-examine upon that matter. Therefore, no examination of witness can be complete if the adverse party is illegally refused permission to cross-examine him or the party calling him is refused permission to re-examine him.

2.5 As per Section 141 of the Indian Evidence Act 141, any question suggesting the answer which the person putting it wishes or expects to receive is called a leading question. As per Section 142, leading questions must not, if objected to by the adverse party be asked in an examination-in-chief, or in a re-examination, except with the permission of the Court. As per Section 143, leading questions may be asked in cross- examination.

2.6 As per Section 146 of the Indian Evidence Act, when a witness is cross-examined, he may, in addition to the questions herein before referred to be asked any questions which tend-

1. To test his veracity.
2. To discover who he is and what is his position in life, or
3. To shake his credit, by injuring his character, although the answer to such questions might tend directly or indirectly to criminate him or might expose or tend directly or indirectly to expose him to a penalty or forfeiture.

3. STAGES OF EXAMINATION

Based on provisions of the Indian Evidence Act mentioned above and provisions of the Income-tax Act, the three stages of examination can be recapitulated as under:

3.1 Examination in Chief: The examination of a witness by a party who calls him is called examination in chief. The object of this examination is to elicit from the witness all the material facts to prove the case of the party calling him. The examiner must not put leading questions to the witness. As per sec. 141 of the Indian Evidence Act, any question suggesting the answer which the person putting it wishes or expects to receive is called a leading question. Any hearsay evidence, i.e., evidence which is not based on the own experience of the witness should not be allowed.

3.1.1 In Income-tax proceedings, the assessee normally introduces evidence either by making a written or oral statement or submits a statement/ confirmation from another party to the transaction. Most of the time this gets substituted as a record of Examination in chief e.g. in case of a cash credit, if the AO insists on examination of the creditor, the confirmation letter is the record of examination-in-chief which is to be subjected to cross examination. Similarly, when an assessee submits an affidavit about loss of books in floods or fire, this becomes his statement in examination-in-chief. If the assessee so wants he can once again go through the process of recording examination-in chief. In

case he is to be further examined, it shall be his cross-examination by the AO to verify the truth in his submission.

3.1.2 The statements recorded u/s 131, 132 or u/s 133A of the IT Act are in the nature of examination-in-chief. As far as such statements of the assessee are concerned, there cannot be a situation of cross-examination by the assessee. But in case of statements of employees, valuers etc., the assessee shall be entitled for a cross-examination of such persons.

3.2 Cross-examination: This is the stage when the party opposite to the party who has produced or requisitioned the witness examines him. The purpose of cross-examination is two-fold, first to weaken, qualify or destroy the case of the opponent; and secondly to establish the party's (in this case department) case by means of the opponent's witnesses. The objects are to impeach the accuracy, credibility and general value of the evidence given in examination-in-chief; to sift the facts already stated by the witness, to detect and expose discrepancies, or to elicit suppressed facts which will support the case of the cross-examining party. Cross-examination differs from examination-in-chief and re-examination in that leading questions can be asked in cross examination.

3.2.1 Cross-examination is not limited to matters to which the witness has testified in his examination-in-chief. But like the examination-in-chief, cross-examination must relate to relevant facts. Cross-examination is an important weapon for destroying the credibility of a witness. If a witness has given testimony in favour of the assessee, the cross-examination may bring to surface his bias owing to his relationship with the assessee. Where a person who testified to having given a large loan to the assessee which has not been returned to date, had to admit in the course of cross-examination that he was for past two years unemployed and that only an year earlier he had sold land to manage household expenses and that he had no money in his bank account, it became clear that his testimony was not reliable.

3.2.2 Mention may also be made of a witness who turns hostile, meaning thereby that he conducts himself in such a manner that his testimony in examination-in-chief goes against the party who has called him. If the court declares him hostile, the party who had called him, gets the right to cross-examine him.

3.3 Re-examination: The object of re-examination is to afford the party calling the witness an opportunity of filling in the lacunae or explaining the inconsistencies which the cross-examination has discovered in the examination-in-chief of the witness. It is accordingly limited to the explanation of matters referred to in cross-examination. It partakes the nature of examination-in-chief in as much as no leading questions can be asked. It may be used for the purpose of removing or diminishing any suspicion that the cross-examination may have cast on the examination-in-chief or to enable the witness to state the whole truth as to matters which have only been partially dealt with in cross-examination. Questions may be asked for explanation of the expressions used by the witness cross-examination. But the party has no right to introduce new matters not suited to explain either the expressions or the motives of the witness. If a question has been omitted in the examination-in-chief, it is usual to request the Court to make an inquiry and such a request is generally granted. If the cross-examination is ineffective, no re-examination, as a rule, should be made.

4. ART OF CROSS–EXAMINATION

4.1 The exercise of the right of cross-examination is regarded as one of the most important procedure for discovery of truth. Yet it has been usually described as "art" because it is as much about the law and facts of the case as the skill of extracting the truth in a particular

situation. While there cannot be any standard way of going about this job, the skill, can be developed and improved upon by keeping in mind the following:

a. The officer must know the case in all its details, and putting himself in the state of assessee, must be mentally clear of the modus operandi adopted by the assessee. Reference to files again and again gives an undue advantage to the assessee, to mentally go over his deposition and change it suitably.

b. Ask innocent questions first, and get the witness to commit himself. The underlying idea in asking innocent questions first is to cut off all possible escapes against incriminating material when the same is presented to the assessee. The best course is to put oneself in the position of a credulous third party.

c. The object of questioning must be kept as disguised as possible. The assessee or witness should not be in a position to guess the underlying import of the various questions.

d. The language for recording the statement should be carefully chosen. If the witness does not or barely understand English, there is no point conducting his cross-examination in English. In all likelihood at a later stage he is going to retract, any adverse inference on the plea that he did not understand language and the translation does not convey what he wanted to say.

e. The objective should always be kept clear in mind. All questions in cross-examination must lead to that objective. By experience an examiner is able to develop a sequence of questions to lead the witness towards his ultimate questions. But if one has no clear objective in mind, he will miss the relevance of many answers for the case. The effort should be to accumulate as many inconsistencies as are possible. These become the circumstantial evidence, whose utility is best when there exists a sequence of events.

f. The officer should try to identify the weak points in the armour of the witness after few initial probes.

g. The officer must have patience. The witness is likely to put off the investigation by giving vague or evasive replies. The examiner's skill is in persisting with his line of interrogation by framing questions differently, more than once.

h. The replies of the witness should be reduced in writing, in his exact words. Examiner need not substitute technical words to sum up or better explain the idea of the witness.

i. The officer should retain the initiative, and must keep control of the questioning. He should hear the witness but not allow him to digress. The witness should not be allowed to be the examiner himself. He should not be allowed to attack which is often the best form of defence.

j. The officer must be clever but he should not try to show off his cleverness. He should be subtle. Many cross-examiners fail because they cannot contain themselves. It would be better the impression given is of an aimless conversation rather than a searching cross-examination.

k. Aggressive approach normally does not help. The officer must keep the whole exercise at an even keel neither making the atmosphere absolutely casual nor absolutely tense. Effort should be to discredit the testimony and not to discredit the witness. Remember, ultimately the information has to come from the witness only. Wherever appropriate, leading questions may be put to the witness as

leading questions are permissible in cross-examination. Patience is the greatest virtue of the cross-examiner. If the witness is lying sooner or later he will trip and contradict himself. Do not shout at witness or try bullying him into admission.

l. Time your questions. It is very difficult to say as to when certain questions are to be put. The cross-examiner has himself to go on mentally assessing the witness and put vital questions at a time when the witness is least likely to realise the significance of the answer himself.

m. Incriminating material and other documentary evidence in possession of the officer, contradicting the testimony of the witness, must be confronted to him during the process itself.

4.2 While examining an expert, it may not serve any purpose to have a lengthy cross-examination in the area of his expertise. Attempt should be made to sift the scientific facts from personal opinion and then show how the expert has been supporting the assessee's case on his personal opinion.

4.3 Similarly where an officer feels that the witness is wilfully and intentionally giving a false testimony, (technically called perjured witness), he should be made to recall a sequence of events. He should try to make him repeat his story by frequent jumping in the sequence. Distracting and taking him to some other related topic for a short while and then returning could upset his rhythm.

4.4 It must be remembered that the procedure of examination of witnesses has evolved in the course of proceedings before trial court with a jury. Cross-examination was almost like a drama where the presiding officer and the jury besides listening to the oral statement could also absorb physical reactions of the witnesses. In a live trial 'body language' of a witness indirectly influences the evaluation of his oral testimony. On the other hand, in Income-tax proceedings the person carrying out the cross examination is himself the presiding officer and there is no jury. Since the real worth of the entire examination shall be known only at the appellate stage, it is imperative to bring out on record, in black and white, all the aspects of the matter, so that a correct appreciation can be made by a third person after a gap of time. The AO can also record the physical reaction of a witness if it has a bearing on the veracity of his testimony.

5. ROLE OF OATH

5.1 While Section 131(1) and 132(4) of the Act authorise the specified officers to examine any person on oath, Section 133A does not mention so. However, Section 4(a) of the Oath Act 1969 provides that oaths or affirmations shall be made by all witnesses, that is to say all persons who may lawfully be examined or give, or be required to give, evidence by or before any court or person having by law or consent of parties authority to examine such persons or to receive evidences. Hence those proceedings under Section 133A could as well be conducted under oath-taking shelter of The Oath Act 1969 but it is better to take statement without oath during general survey under Section 133A as there isno express provision under the Income-tax Act, 1961 in the Section 133A(iii) while the same is there in Section 131, 132(4). Further Section 7 of the Oaths Act provides that failure to take oath or affirmation or any irregularity in administering it, shall neither invalidate the proceedings nor render the evidence inadmissible.

5.2 If oath is not administered, prosecution for perjury *u*/s 181 and 193 of IPC will not stand. Section 181 & Section 191 in The Indian Penal Code stipulates as under:

"181. False statement on oath or affirmation to public servant or person authorised to administer an oath or affirmation- Whoever, being legally bound by an oath or affirmation to state the

truth on any subject to any public servant or other person authorized by law to administer such oath or affirmation, makes, to such public servant or other person as aforesaid, touching the subject, any statement which is false, and which he either knows or believes to be false or does not believe to be true, shall be punished with imprisonment of either description for a term which may extend to three years, and shall also be liable to fine."

"191. Giving false evidence.-Whoever, being legally bound by an oath or by an express provision of law to state the truth, or being bound by law to make a declaration upon any subject, makes any statement which is false, and which he either knows or believes to be false or does not believe to be true, is said to give false evidence."

5.3 The Section 193 of the Indian Penal Code stipulates for punishment for false evidence as under:

"193. Punishment for false evidence.—Whoever intentionally gives false evidence in any stage of a judicial proceeding, or fabricates false evidence for the purpose of being used in any stage of a judicial proceeding, shall be punished with imprisonment of either description for a term which may extend to seven years, and shall also be liable to fine, and whoever intentionally gives or fabricates false evidence in any other case, shall be punished with imprisonment of either description for a term which may extend to three years, and shall also be liable to fine."

6. REFERENCE MATERIAL ON CROSS-EXAMINATION

6.1 The classic work on the art of cross examination is by Francis C. Wellman, one of the greatest trial lawyers of U.S.A. named "The Art of Cross Examination," published by Macmillan Co. This monumental work has reigned supreme for several years and has instructed generations of budding lawyers. Some of the tips given by him are reproduced below in quotes:

6.2 The Matter of Cross-examination: "If, perchance, you obtain a really favourable answer, leave it and pass quietly to some other inquiry. The inexperienced examiner in all probability will repeat the question with the idea of impressing the admission upon his hearers, instead of reserving it for the summing up, and will attribute it to bad luck that the witness corrects his answer or modifies it in some way, so that the point is lost. He is indeed a poor judge of human nature who supposes that if he exults over his success during the cross examination, he will not quickly put the witness on his guard to avoid all future favourable disclosures."

"Often times the main point in litigation depends upon the correct version given of a conversation where only two persons are present, usually the opposing parties themselves. In a case of that kind the direct testimony of either is often of such a character that there is no hope of obtaining a contradiction out of the mouth of the witness himself. Here, the skilful cross-examiner would ignore the testimony given by the witness in chief and confine his efforts almost exclusively to destroying the witness, if possible, by attacking his integrity in connection with entirely collateral matters."

6.3 Cross-examination of Experts: "It has become a matter of common observation that not only the honest opinions of different experts be obtained upon opposite sides of the same question, but also that dishonest opinions may be obtained upon different sides of the same question.

Attention is also called to the distinction between matters of scientific fact and mere matters of opinion. For example: medical experts may be called to establish certain medical facts which are not mere matters of opinion. On such facts the experts could hardly disagree; but in the province of opinion it is well known that the

experts differ so widely among themselves that but little credit is given to mere expert opinions as such.

As a general thing, it is unwise for the cross-examiner to attempt to cope with a specialist in his own field of inquiry. Lengthy cross-examinations along the lines of the expert's theory are usually disastrous and should rarely be attempted."

"On the other hand, some careful and judicious questions, seeking to bring out separate facts and separate points from the knowledge and experience of the expert, which will tend to support the theory of the attorney's own side of the case, are usually productive of good results. In other words, the art of the cross-examiner should be directed to bring out such scientific facts from the knowledge of the expert as will help his own case, and thus tend to destroy the weight of the opinion of the expert given against him.

Another suggestion which should always be borne in mind is that no question should be put to an expert which is in any way so broad as to give the expert an opportunity to expatiate upon his own views, and thus afford him an opportunity in his answer to give his reasons, in his own way, for his opinions, which counsel calling him as an expert might not otherwise have fully brought out in his examination."

6.4 The Sequence of Cross-examination: "Much depends upon the sequence in which one conducts the cross-examination of a dishonest witness. You should never hazard the important question until you have laid the foundation for it in such a way that, when confronted with the fact, the witness can neither deny nor explain it."

"If you have in your possession a letter written by the witness, in which he takes an opposite position on some part of the case to the one he has just sworn to, avoid the common error of showing the witness the letter for identification, and then reading it to him with the inquiry, "What have you to say to that?" During the reading of his letter the witness will be collecting his thoughts and getting ready his explanations in anticipation of the question that is to follow, and the effect of the damaging letter will be lost.

The correct method of using such a letter is to lead the witness quietly into repeating the statements he has made in his direct testimony, and which his letter contradicts, "I have you down as saying so and so; will you please repeat it? I want to be accurate." The witness will repeat his statement. Then write it down and read it off to him. "Is that correct? Is there any doubt about it? For if you have any explanation or qualification to make, I think you owe it to us, in justice, to make it before I leave the subject." The witness has none. He has stated the fact; there is nothing to qualify; note it and make him sign it. Then let your whole manner toward him suddenly change, and spring the letter upon him. "Do you recognise your own handwriting, sir? Let me read you from your own letter, in which you say," - and afterward - "Now, what have you to say to that?"

6.5 Silent Cross-examination: "Nothing could be more absurd or a greater waste of time than to cross-examine a witness who has testified to no material fact against you. It not infrequently happens that such unnecessary examinations result in the development of new theories of the case for the other side; and a witness who might have been disposed of as harmless by mere silence, develops into a formidable obstacle in the case."

6.6 Two "Lurking, if not Great, Dangers", that Confront a Cross-examiner: 'Cross-examination is usually regarded as the means by which adverse witnesses are discredited, and it is for that purpose that it is usually employed by the Bar. The importance of it in that regard is self-evident. If through the instrumentality of the cross-examination the integrity of the witness is destroyed, even though it be not with respect to the particular testimony given at the trial, if his general reputation for truth and veracity is shown to be bad by his own utterances, clearly

the examiner has very greatly helped his case. In this effort, however, there are two lurking, if not great, dangers. *One is to cross-examine when it is quite unnecessary, and the other to overdo the cross-examination*.

7. LEGAL POSITION

7.1 The authorized officer can go to the house of the assessee and open his camp office and serve notice on him to depose at his camp office in residence of assessee. [*DDIT (Inv.) vs. Prakash V. Sanghvi** [2015] 64 taxmann.com 221 (Karnataka)].

7.2 The powers under Section 131(1A) are not hindered by the conduct of the search. It can be invoked both before and after the conduct of the search. *Arti Gases vs. DIT* [2001] 248 ITR 55 (Gujarat), *Neesa Leisure Ltd. vs. Union of India* [2011]338 ITR 460 [Gujarat], *Emaar Alloys (P.) Ltd. vs. DGIT* [2015] 64 taxmann.com 67 (Jharkhand)

7.3 A statement under Section 133A does not loose its evidentiary value merely because it was statement without oath, if the said statement is not the sole evidence but one of the evidences justifying addition. The decision in the matter of *CIT vs. S. Khader Khan Son* [2013] 352 ITR 480/ [2012] 210 Taxmann 248/ 25 taxmann.com 413 (SC) arising from the decision of Madras High Court in *CIT vs. S. Khader Khan Son* [2008] 300 ITR 157 proceeded on the fact that the sole evidence against the assessee in that case was the statement made on oath during the survey proceedings. [*Dr. Dinesh Jain vs. ITO* [2014] 45 taxmann.com 442 (Bombay)]

7.4 Statement recorded under Section 133A(3)(iii) though cannot be treated as independent evidence like evidence recorded under Section 4)132), but it has corroboratory value in assessment and statement recorded under the said provision can be even relied on by the assessee. The decision of the Kerala High Court in *Paul Mathews & Sons vs. CIT* [2003] 263 ITR 101 that the statement recorded under the above provision does not have evidentiary value, does not lay down the correct law. [*CIT vs. Hotel Samrat* [2010] 323 ITR 353 (Kerala)].

APPENDIX - I

Order XVIII, CIVIL PROCEDURE CODE

Hearing of the Suit and Examination of witnesses:

1. The Plaintiff has the right to begin unless the defendant admits the facts alleged by the plaintiff and contends that either in point of law or on some additional facts alleged by the defendant, the plaintiff is not entitled to any part of the relief which he seeks, in which case the defendant has the right to begin.

2. (1) On the day fixed for the hearing of the suit or on any other day to which the hearing is adjourned, the party having the right to begin shall state his case and produce his evidence in support of the issues which he is bound to prove. (2) The other party shall then state his case and produce his evidence (if any) and may then address the Court generally on the whole case.(3) The party beginning may then reply generally on the whole case.

3. Where there are several issues, the burden of proving some of which lies on the other party, the party beginning may, at his option, either produce his evidence on those issues or reserve it by way of answer to the evidence produced by the other party; and in the latter case, the party beginning may produce evidence on those issues after the other party has produced all his evidence, and the other party may then reply specially on the evidence so produced by the party beginning; but the party beginning will then be entitled to reply generally on the whole case.

4. The evidence of the witnesses in attendance shall be taken orally in open Court in the presence and under the personal direction and superintendence of the Judge.

5. In cases in which an appeal is allowed the evidence of each witness shall be taken down in writing, in the language of the Court, by or in the presence and under the personal direction and superintendence of the Judge, not ordinarily in the form of question and answer, but in that of the Judge and of the witness, and the Judge shall, if necessary, correct the same, and shall sign it.

6. Where the evidence is taken down in a language different from that in which it is given, and the witness does not understand the language in which it is taken down, the evidence as taken down in writing shall be interpreted to him in the language in which it is given.

7. Evidence taken down under Section 138 shall be in the form prescribed by rule 5 and shall be read over and signed and, as occasion may require, interpreted and corrected as if it were evidence taken down under that rule.

8. Where the evidence is not taken down in writing by the Judge, he shall be bound, as the examination of each witness proceeds, to make a memorandum of the substance of what each witness deposes, and such memorandum shall be written and signed by the Judge and shall form part of the record.

9. Where English is not the language of the Court, but all the parties of the suit who appear in person, and the pleaders of such as appear by pleaders, do not object to have such evidence as is given in English taken down in English, the Judge may so take it down.

10. The Court may, of its own motion or on the application of any party or his pleader, taken

down any particular question and answer, or any objection to any question, if there appears to be any special reason for so doing.

11. Where any question put to a witness is objected to by a party or his pleader, and the Court allows the same to be put the Judge shall taken down the question, the answer, the objection and the name of the person making it, together with the decision of the Court thereon.

12. The Court may record such remarks as it thinks material respecting the demeanour of any witness while under examination.

13. In cases in which an appeal is not allowed, it shall not be necessary to take down the evidence of the witnesses in writing at length; but the Judge, as the examination of each witness proceeds, shall make a memorandum of the substance of what he deposes, and such memorandum shall be written and signed by the Judge and shall form part of the record.

14. (1) Where the Judge is unable to make a memorandum as required by this Order, he shall cause the reason of such inability to be recorded, and shall cause the memorandum to be made in writing from his dictation in open court. (2) Every memorandum so made shall form part of the record.

15. (1) Where a Judge is prevented by death, transfer or other cause from concluding the trial of suit, is successor may deal with any evidence or memorandum taken down or made under the foregoing rules as if such evidence or memorandum had been taken down or made by him or under his direction under the said rules and may proceed with the suit from the stage at which his predecessor left it. (2) The provisions of sub-rule (1) shall, so far as they are applicable, be deemed to apply to evidence taken in a suit transferred under Section 24.

16. (1) Where a witness is about to leave the jurisdiction of the Court, or other sufficient cause is shown to the satisfaction of the Court why his evidence should be taken immediately, the Court may, upon the application of any party or of the witness, at any time after the institution of the suit, take the evidence of such witness in manner hereinbefore provided. (2) Where such evidence is not taken forthwith and in the presence of the parties, such notice as the Court thinks sufficient, of the day fixed for the examination, shall be given to the parties. (3) The evidence so taken shall be read over to the witness, and, if he admits it to be correct, shall be signed by him, and the Judge shall, if necessary, correct the same, and shall sign it, and it may be read at any hearing of the suit.

17. The Court may at any stage of a suit recall any witness who has been examined and may (subject to the law of evidence for the time being in force) put such questions to him as the Court thinks fit.

18. The Court may at any stage of a suit inspect any property or thing concerning which any question may arise.

APPENDIX - II

Order XIX, CIVIL PROCEDURE CODE

Affidavits

1. Any Court may at any time for sufficient reason order that any particular fact or facts may be proved by affidavit, or that the affidavit of any witness may be read at the hearing, on such conditions as the Court thinks reasonable:

Provided that where it appears to the Court that either party bona fide desires the production of a witness for cross-examination, and that such witness can be produced, an order shall not be made authorising the evidence of such witness to be given by affidavit.

2. (1) Upon any application evidence may be given by affidavit, but the Court may, at the instance of either party, order the attendance for cross-examination of the deponent. (2) Such attendance shall be in Court, unless the deponent is exempted from personal appearance in Court, or the Court otherwise directs.

3. (1) Affidavits shall be confined to such facts as the deponent is able of his own knowledge to prove, except on interlocutory application, on which statements of his belief may be admitted: provided that the grounds thereof are stated. (2) The costs of every affidavit which shall unnecessarily set forth matters of hearsay or argumentative matter, or copies of or extracts from documents, shall (unless the Court otherwise directs) be paid by the party filing the same.

CHAPTER

20

Law on Tax Avoidance and GAAR

1. TAX AVOIDANCE— AN INTRODUCTION

1.1 In order to ensure an efficient and effective tax administration it is imperative to understand the ways and means in which taxation provisions are applied by the tax payers, and whether the said application adheres to the letter and spirit of the law. The most rudimentary manner of applying tax laws is pure compliance in which taxes are paid as per the provisions of the law and as per the legislative intent. This is the simplest and most passive style of applying tax laws. A slightly more complex manner is tax mitigation in which more complex provisions of law are resorted to in order to reduce taxation. The same is also done in accordance with law. These are the most basic forms of application of tax laws and do not give rise to any disputes i.e. the position of stated income and tax payable and paid as per the taxpayer, are accepted by the income-tax authorities.

1.2 However, the more situations arise where there is tax planning, tax avoidance or tax evasion. Tax planning is arranging one's financial affairs, one's transactions in such a manner that tax reduction is achieved and which is in accordance with law. It is both legal and legitimate and is perhaps more systematic and planned tax mitigation. Tax evasion, however, is at the other end of the compliance spectrum. Tax evasion is deliberate under-reporting of income by either suppressing the receipts or inflating the expenses and involves active non-disclosure of facts and fabrication of incorrect information. It is, therefore, both illegal and illegitimate.

1.3 Tax avoidance is an arrangement of financial affairs in a manner that yields results that are not in consonance with the intention of the legislature. In principle it sits in between tax planning and tax evasion and there are no precise, easily identifiable boundaries between the three terms. Tax avoidance is the attempt to avoid payment of taxes or payment of less tax, without apparently violating the legislative mandate, but by defeating the legislative intent. Tax avoidance may not be illegal, but it is certainly illegitimate. It is important for an assessing officer to identify such cases of tax avoidance, to ensure that taxpayers pay their legitimate tax dues.

1.4 Thus in the case of tax avoidance, the taxpayer circumvents the law without giving rise to a criminal offence (as would occur in cases of tax evasion) by using a scheme, arrangement or device, often of a complex nature but where the main purpose is to defer, reduce or completely avoid the tax payable under law. Arrangement of affairs that reduce a taxpayer's tax liabilities that was not intended as per tax law would fall under tax avoidance.

1.5 The Australian Income-tax Act describes avoidance as 'defeating, evading or avoiding any duty or liability imposed on any person by this Act'. This definition gave rise to a dispute regarding what is 'avoidance of any liability imposed'. An argument was raised that the provision would cover only a liability that had already arisen. This was judicially clarified by Lord Denning in the following words:

Their Lordships ….. are clearly of opinion that the word 'avoid' is used in its ordinary sense - in the sense in which a person is said to avoid something which is about to happen to him. He takes steps to get out of the way of it. It is this meaning of 'avoid' which gives the clue to the meaning of 'liability imposed'. To 'avoid a liability imposed' on you means to take steps to get out of the reach of a liability which is about to fall on you. If the submission of (the counsel for the taxpayer) were accepted, it would deprive the words of any effect; for no one can displace the liability to tax which has already accrued due, or in respect of income which has already been derived.

1.6 As stated earlier, the concept of tax avoidance lies in between tax planning and tax evasion, and therefore as such it is an imprecise concept. The financial environment is constantly changing and the same affects tax laws. Due to the inherent dynamic nature of tax systems which are affected by the prevailing economic and financial scenario and vice versa, designing a tax system where there is no possibility of tax avoidance is not a practically achievable goal, and so there are tax avoidance possibilities inherent in all tax systems- however flexible or inflexible they may be. Therefore, whether a particular case qualifies as a case of tax avoidance will essentially involve a fact-finding exercise.

1.7 It is important to understand that any bona fide commercial transaction, though it may result in tax reduction, should not ordinarily be construed as an avoidance measure. There are no clear objective parameters or tests to identify whether a transaction or financial arrangement is one of tax avoidance. Therefore, whether an arrangement has been carried out for bona fide commercial reasons or for avoidance purposes, is a question of fact.

2. SHAM, FICTITIOUS AND ARTIFICIAL TRANSACTIONS

2.1 Certain terms have been traditionally used in the context of tax avoidance and tax evasion. Though sometimes their meanings overlap, the courts have attempted to give them precise meanings. They have, however, cautioned that the exact meaning of any such term should be construed in the context of the particular facts of the case. It is important to understand that these terms or transactions may not be exclusive to cases of tax avoidance, and may easily be cases of tax evasion depending upon whether the same involves a misrepresentation of facts, suppression of information etc. But an understanding of these terms is crucial to both cases of tax avoidance and tax evasion.

2.2 A 'sham' is defined in the Oxford English Dictionary as *'something that is intended to be taken for something else, or that is not what it purports to be; a spurious imitation, a counterfeit...something not genuine or true'*. The judicial meaning of a 'sham' transaction is to be found in *Snook vs. London and West Riding* Investment Ltd (1967) 1 All ER 518, a case on the Hire Purchase Act:

> *.....if it has any meaning in law, it means act done or documents executed by the parties to the 'sham' which are intended*

by them to give to third parties or to the court the appearance of creating between the parties legal rights and obligations different from the actual rights and obligations (if any) which the parties intend to create.

Thus a sham transaction is a function of tax evasion.

2.3 The dictionary meaning of 'fictitious' is *'artificial; counterfeit; sham, not genuine'*. In considering the meaning of a 'fictitious' transaction in *CEC vs. CIR* (1971) 2 MLJ 43, the Board of Review said:

"As the Section (i.e. Section 33) draws a distinction between artificial and fictitious, fictitious in the context of the Section must mean sham, not genuine."

A fictitious transaction, when well clothed by legal documentation is normally employed as a tool for tax evasion.

2.4 An artificial transaction is always used for devising a scheme for tax avoidance. It would normally have no other function except lowering or transferring of the incidence of tax. It can easily be identified by absence of any commercial or economic significance. In the Privy Council case of *Sermaco Ltd. Superannuation Fund Trustees vs. ITC* (1977) AC 287, their Lordships drew a distinction between the terms 'artificial' and 'fictitious':

A fictitious transaction is one, which those who are ostensibly the parties to it never intended should be carried out. 'Artificial' as descriptive of a transaction is, in their Lordships' view a word of wider import.....where the arrangements in question go beyond more than one would expect to find between independent parties engaging in normal commercial transactions, especially where there are terms which suggest that the only real purpose for the arrangements is a tax advantage, then those arrangements may properly be regarded as artificial.

3. PURPOSE OF TAX AVOIDANCE

In the context of 'tax avoidance purpose', Lord Denning observed in *Newton v. CIT* (1958) AC 450:

..... The word 'purpose' means, not motive, but the effect which it is sought to achieve - the end in view. The word 'effect' means the end accomplished or achieved. The whole set of words denotes concerted action to an end - the end of avoiding tax.

Lord Upjohn in *CIR v. Brebner* 43 TC 705 observed:

...when the question of carrying on a genuine commercial transaction is considered, the fact that there are two ways of carrying it out-one by paying the maximum amount of tax, the other by paying no or much less tax-it would be quite wrong as a necessary consequence to draw the inference that in adopting the latter course one of the main objects is avoidance of tax. No commercial man in his senses is going to carry out bona fide commercial transactions except upon the footing of paying the smallest amount of tax involved.

4. FORM *VS.* SUBSTANCE–THE INTERNATIONAL CONTEXT

4.1 The dispute relating to the 'substance over form doctrine' is at the core of the subject of tax avoidance. The substance over form doctrine maintains that the 'substance' rather than the 'form', of a transaction is what governs the tax consequences of a transaction. Central to this doctrine of substance over form is the question as to whether the court can bring a transaction within the taxing provisions by taking a broad view of the facts, not limited to the apparent structure of financial transaction or the manner in which the financial affairs have been presented, and conclude that they represent a situation which is substantially within the contemplation of the tax laws.

4.2 'Form' means the legal rights and obligations created by one or more transactions. 'Substance' refers to the overall financial and economic realities, rather than only the legal form of transactions.

4.3 The great controversy of 'form and substance' was settled in 1936 by the House of Lords decision in CIR v. Duke of Westminster 19 TC 490. In this case, the Duke, with the object of reducing his liability to surtax, had prevailed upon a number of his employees who were in receipt of wages to enter into agreements whereby they agreed to accept annuity payments made under deeds of covenant. The deeds provided that the payments were to be without prejudice to any claim for remuneration to which the employee might thereafter be entitled. It was represented to all employees, except one, that each employee was not expected to make any such claim so long as the amount received under the covenant and any other payments he received equaled his current salary.

4.4 The Revenue contended that although the transaction was in the form of a grant of an annuity, the substance of the matter was that the annuity payments were in reality wages. This contention was rejected by both the Court of Appeal and the House of Lords. Lord Tomlin observed:

> *....it is said that in revenue cases there is a doctrine that the court may ignore the legal position and regard what is called 'the substance of the matter', and that here the substance of the matter is that annuitant was serving the Duke for something equal to his former salary or wages, and that therefore, while he is so serving, the annuity must be treated as salary or wages. This supposed doctrine..... seems to rest for its support upon a misunderstanding of language used in some earlier cases. The sooner this misunderstanding is dispelled and the supposed doctrine given its quietus, the better it will be for all concerned.... Every man is entitled if he can to order his affairs so as that the tax attaching under the appropriate Acts is less than it otherwise would be. If he succeeds in ordering them so as to secure this result, then, however, unappreciative the Commissioners of Inland Revenue or his fellow taxpayers may be of his ingenuity, he cannot be compelled to pay an increased tax. This so-called doctrine of 'the substance' seems to me to be nothing more than an attempt to make a man pay notwithstanding that he has so ordered his affairs that the amount of tax sought from his is not legally claimable.*

The following extract from the judgment of Lord Russell of Killowen in the same case is equally illustrative:

> *The subject is not taxable by inference or by analogy, but only by the plain words of a statute applicable to the facts and circumstances of his case. As Lord Cairns said many years ago in Partington v. AG (1869) LR 4 ES App HII 100, at page 122): "As I understand the principle of all fiscal legislation, it is this.. If the person sought to be taxed comes within the letter of the law he must be taxed, however great the hardship may appear to the judicial mind to be. On the other hand, if the Crown seeking to recover the tax, cannot bring the subject within the letter of the law, the subject is free, however apparently within the spirit of the law the case might otherwise appear to be'.*

This principle of form over substance is commonly referred to as the Westminster principle and is generally regarded as applicable to all transactions, except where such transactions are sham transactions or, where the application of the principle is statutorily restricted or negated.

5. EVOLUTION OF LEGAL POSITION ON TAX AVOIDANCE

5.1 The English law on tax avoidance further evolved over the years in three cases. The first of these cases is the landmark decision in WT

Ramsay *vs.* CIR [1981] STC 174. The facts of the case are as below:

The taxpayer company (R) entered into a tax avoidance scheme to create an allowable capital loss for set-off against a taxable capital gain. If the scheme had withstood the scrutiny of the courts, liability to capital gains tax would have been fully avoided. Under the scheme, R bought the whole of the issued share capital in a company (C). It also made two loans to C of $ 218750 each. These loans carried interest at the rate of 11%. The funds for these loans were provided by the vendors of the scheme. R was given the right to decrease the interest rate on one loan and to increase correspondingly the interest rate on the other. This right was exercised. As a result, the interest rate on one loan dropped to nil and it rose to 22% on the other loan. The latter loan was sold for $391481, thus giving rise to a gain of $172731. The second loan was subsequently repaid at par. The shares in C were originally acquired by R for $185034. These were subsequently sold for P.S. 9387, hence resulting in a loss of $175,647.

5.2 The essence of the scheme was to include a transaction designed to produce a loss to be offset against a gain previously made by R. Without this loss, the gain would otherwise be chargeable to capital gain tax. At the same time, another transaction was designed to produce a matching gain, which was not chargeable to tax. These separate transactions were not shams, but they were self-canceling.

5.3 Lord Wilberforce thought that it would be wrong to pick out and stop at the one step in the combination which produced the loss, since the loss was dependent on and was merely a reflection of the gain. The true view, he said, regarding the scheme as a whole, was to find that there was no gain or loss. The loss of $175647 was accordingly held not to amount an allowable loss for capital gains tax purposes. The following observation was made in this case:

> *"Given that a document or transaction is genuine, the court cannot go behind it to some supposed underlying substance. This is the well-known principle of Inland Revenue Commissioners v. Duke of Westminster [1936] AC1. This is a cardinal principle but it must not be overstated or overextended. While obliging the court to accept documents or transactions, found to be genuine, as such, it does not compel the court to look at a document or a transaction in blinkers, isolated from any context to which it properly belongs. If it can be seen that a document or transaction was intended to have effect as part of a nexus or series of transactions, or as an ingredient of a wider transaction intended as a whole, there is nothing in the doctrine to prevent it being so regarded.: to do so is not to prefer form to substance, or substance to form. It is the task of the court to ascertain the legal nature of any transaction to which it is sought to attach a tax or a tax consequence and if that emerges from a series or combination of transactions, intended to operate as such, it is that series or combination which may be regarded."*

5.4 Thus the House of Lords cautioned against a series of transactions which are pre-ordained, inserted into, which are steps that have no commercial purpose apart from tax avoidance.

5.5 The second case is the case of *IRC vs. Burma Oil Co Ltd.* (1982) STC 30. In this case a block of shares was transferred by B to one of its subsidiaries, C, but the purchase price was left outstanding and the amount placed in a loan account in B's books was $379,924,999. Some three years letter, the same block of shares was sold by C to B for $220625000. This reduced the loan due to B to $159,299,999. Since C was at that time insolvent, this debt was obviously worthless to B.

5.6 Under UK's capital gains tax legislation, the loss on a simple debt was not recognised as an

allowable loss. To obtain an allowable loss, B embarked upon a scheme to convert the simple debt to equity. B advanced $159,299,999 to another of its subsidiaries, D. The same amount was lent by D to C which repaid its debt to B. All these transactions took place on the same day. Six days later, another series of transactions took place. A rights issue was made by C.B. applied for and was allotted all the unissued shares in C. For these, it paid C $159,600,000. Out of the subscription money received, C repaid its debt ($159,299,999) to D which in turn repaid its debt ($159,299,999) to B. All these transactions also took place on the same day.

Shortly afterwards, C was voluntarily wound up. B claimed that it was entitled to deduct the payments made under the rights issue in computing the allowable loss on the disposal of its entire share holdings in C (on C's liquidation).

Applying the *Ramsay* doctrine, B was denied deduction for the payments made under the rights issue.

5.7 The third case important case regarding this issue is *Furniss v. Dawson* [1984] STC 153. In this case, the taxpayer, D, wished to sell to W his shares in two companies (Cs). In order to defer the capital gains tax on the chargeable gain which would arise on a direct sale to W, D embarked upon a scheme. Under this scheme, an investment company, G, was incorporated and all its issued shares were held by D. D's shareholdings in Cs were sold to G in exchange for shares in G. In turn, G sold these shares to W. Both transactions took place on the same day.

5.8 Applying the ratio of decisions in *Ramsay* and *Burmah Oil*, the transactions inserted between D and G were disregarded. D was accordingly held to have disposed of the shares in Cs in favour of W in consideration of a sum of money paid with D's concurrence to G. In Ramsay, it was therefore decided that the court is entitled to consider the separate steps comprised in a composite transaction or scheme in the context of the scheme as a whole. The court is not compelled by the Westminster doctrine to confine itself to a step-by-step examination, even if the separate steps are genuine rather than sham.

5.9 Originally, it was considered that the *Ramsay doctrine* was counter to the Westminster doctrine. However, as subsequently, held by the Hon'ble Supreme Court of India, both the Westminster Doctrine and Ramsay Doctrine need to be read harmoniously. The conclusion of both cases is that tax mitigation which is within the confines of law should not be viewed adversely unless dubious means and transactions, colorable devices etc. have been resorted to. The following major principles emerged which were indicative of a tax mitigation scheme, possibly being a case of tax avoidance:

- Where steps having no commercial (business) purpose apart from the avoidance of a liability to tax are inserted in a composite transaction (made up of a pre-ordained series of transactions), the inserted steps are to be disregarded for fiscal purposes. This is regardless of whether the composite transaction includes the achievement of a legitimate commercial (i.e. business) end.
- It is not confined to circular and self-canceling transactions.
- It is not confined to steps inserted for tax avoidance purposes which have no enduring legal consequences.
- It is not confined to a composite transaction which entails the creation of an artificial loss.

6. FORM *VS.* SUBSTANCE IN THE INDIAN SCENARIO

6.1 In India, the Westminster doctrine held the sway till mid-80s and it was held that "avoidance of tax is not tax evasion and it carries no ignominy with it, for it is sound law and, certainly not bad morality, for anybody to so arrange its affairs as to reduce the brunt of taxation to a minimum" (Per Jagadisan J.) This position was affirmed by the Supreme Court in the case of *Jivaji Rao vs.*

CIT [34 ITR 888] and in many other decisions subsequently.

6.2 The following observations of the *Supreme Court in CIT vs. Raman & Co.* [1986] 67 ITR 11 *(SC) and CIT v. Kharwar* [1969] 72 ITR 603 (SC) respectively, bring out clearly the prevalent thinking on the subject:

> *"Avoidance of tax liability by so arranging commercial affairs that charge of tax is distributed is not prohibited. A taxpayer may resort to a device to divert the income before it accrues or arises to him. Effectiveness of the device depends not upon considerations of morality, but on the operation of the Income-tax Act. Legislative injunction in taxing statutes may not, except on peril of penalty, be violated, but it may lawfully be circumvented.*
>
> *The taxing authority is entitled and is indeed bound to determine the true legal relation resulting from a transaction. If the parties have chosen to conceal by a device the legal relation, it is open to the taxing authorities to unravel the device and to determine the true character of the relationship. But the legal effect of a transaction cannot be displaced by probing into the 'substance of the transaction."*

6.3 This doctrine again came under scrutiny of the Full Bench of the Supreme Court again in the case of *McDowell and Co Ltd. vs. CTO* [154 ITR 148]. The judgement in the case of McDowell was considered to have taken new look in fiscal jurisprudence which was in tune with the thinking in case of *W.T. Ramsay Ltd. vs. IRC*, Inland Revenue Commissioners v. Burmah Oil Company Ltd and Furniss v. Dawson. In the McDowell case, the majority decision delivered by Justice Mishra held that *'tax planning may be legitimate, provided it is within the framework of the law*'. However, it also held that '*colourable devices cannot be a part of tax planning and it is wrong to encourage the belief that it is honourable to avoid payment of tax by resorting to dubious methods'*.

6.4 This concept of 'Substance *vs.* Form' was once again revisited in the case of *Union of India v. Azadi Bachao Andolan* [Appeal (C) 8161–8162 of 2003]. While upholding Board's Circular No. 789 dated April 13, 2000 that recognised residency certificate for obtaining benefits under treaty, the Hon'ble Supreme Court also analyzed its judgement in the case of McDowell and made the following observation:

> *Interestingly, even in McDowell, though Chinnappa Reddy J., dismissed the observation of J.C. Shah J. in CIT v. A. Raman and Company based on Westminster and Fisher's Executors, by saying "we think that the time has come for us to depart from the Westminster principle as emphatically as the British courts have done and to dissociate ourselves from the observations of Shah J., and similar observations made elsewhere", it does not appear that the rest of the learned Judges of the Constitutional Bench contributed to this radical thinking. Speaking for the majority, Ranganath Mishra J., (as he then was) says in McDowell: "Tax planning may be legitimate provided it is within the framework of law. Colourable devices cannot be part of tax planning and it is wrong to encourage or entertain the belief that it is honourable to avoid the payment of tax by resorting to dubious methods. It is the obligation of every citizen to pay the taxes honestly without resorting to subterfuges.*
>
> ***—Emphasis Added***

6.5 The Hon'ble Supreme Court after further analyzing various decisions observed that the principles in Duke of Westminister is not departed from subsequently and every attempt at tax

planning should not be viewed with disfavour. It observed as under:

> *We may in this connection usefully refer to the judgment of the Madras High Court in M.V. Vallipappan and others v. ITO, which has rightly concluded that the decision in McDowell cannot be read as laying down that every attempt at tax planning is illegitimate and must be ignored, or that every transaction or arrangement which is perfectly permissible under law, which has the effect of reducing the tax burden of the assessee, must be looked upon with disfavour*
>
> *We may also refer to the judgment of Gujarat High Court in Banyan and Berry v. Commissioner of Income-tax where referring to McDowell, the Court observed: "The court nowhere said that every action or inaction on the part of the taxpayer which results in reduction of tax liability to which he may be subjected in future, is to be viewed with suspicion and be treated as a device for avoidance of tax irrespective of legitimacy or genuineness of the act; an inference which unfortunately, in our opinion, the Tribunal apparently appears to have drawn from the enunciation made in McDowell case (1985) 154 ITR 148 (SC). The ratio of any decision has to be understood in the context it has been made. The facts and circumstances which lead to McDowell's decision leave us in no doubt that the principle enunciated in the above case has not affected the freedom of the citizen to act in a manner according to his requirements, his wishes in the manner of doing any trade, activity or planning his affairs with circumspection, within the framework of law, unless the same fall in the category of colourable device which may properly be called a device or a dubious method or a subterfuge clothed with apparent dignity."*
>
> ***—Emphasis Added***

6.6 Thus it is clear that while the Hon'ble Supreme Court upholds legitimate tax panning, and cautions revenue from viewing every tax mitigation step with disfavour, any attempt to avoid payment of legitimate tax dues by dubious means cannot be exempt from further examination. The Court further reproduced passage from American Jurisprudence which reemphasized this view:

> *The situation in the United State is reflected in the following passage from American Jurisprudence: "The legal right of a taxpayer to decrease the amount of what otherwise would be his taxes, or altogether to avoid them, by means which the law permits, cannot be doubted. A tax-saving motivation does not justify the taxing authorities or the courts in nullifying or disregarding a taxpayer's otherwise proper and bona fide choice among courses of action, and the state cannot complain, when a taxpayer resorts to a legal method available to him to compute his tax liability, that the result is more beneficial to the taxpayer than was intended. It has even been said that it is common knowledge that not infrequently changes in the basic facts affecting liability to taxation are made for the purpose of avoiding taxation, but that where such changes are actual and not merely simulated, although made for the purpose of avoiding taxation, they do not constitute evasion of taxation. Thus, a man may change his residence to avoid taxation, or change the form of his property by putting his money into nontaxable securities, or in the form of property which would be taxed less, and not be guilty of fraud. On the other hand, if a taxpayer at assessment time converts taxable property into non-taxable property for the purpose of avoiding taxation, without intending a permanent change, and shortly after the time for*

assessment has passed, reconverts the property to its original form, it is a discreditable evasion of the taxing laws, a fraud, and will not be sustained."

—Emphasis Added

6.7 The above principles were reemphasized in the case of *Vodafone International Holdings BV Netherlands vs. Union of India* (Civil Appeal No. 733 of 2012), where it was held that there was no conflict between the decisions in the case of McDowell and Azadi Bachao. The Supreme Court observed that Ramsay did not discard Westminster but read it in the proper context by which "device" which was colourable in nature had to be ignored as fiscal nullity. Thus, the Supreme Court observed that Ramsay lays down the principle of statutory interpretation rather than an over-arching anti-avoidance doctrine imposed upon tax laws.

7. IDENTIFICATION OF TAX AVOIDANCE IN ASSESSMENT

7.1 In view of the above judicial precedents, it is important to understand that every tax mitigation effort cannot be viewed adversely if it is in accordance with the legal framework. For instance, where a claim is supported by perfectly legal documentation and provisions, it would not be correct to reject the claim by way of reference to 'McDowell' on a mere surmise that the exercise is that of tax avoidance. The AO has to bring out the surrounding circumstances and corroborating evidence to show that a formally legal facade has been created with a view to camouflage the real state of affairs with the only object of avoiding tax and that there was no commercial purpose for the same, other than minimizing the tax incidence.

7.2 Thus what needs to be done in each case is to establish that the case is not that of tax planning but tax avoidance by bringing out all relevant facts on record. Some of the most commonly deployed methods of reducing tax incidence, which may be indicative of tax avoidance are as below:

- **Mischaracterization:** where income and deductions are given different form to qualify for a more generous treatment e.g. business income may be characterized as capital gain to benefit from a more favourable tax rate.
- Deferral of recognition of gains e.g. avoiding gains on sale of assets by using reorganisation rules.
- **Transfer Pricing:** Entering in related party transactions at other than fair market value to increase deductible costs or reduce assessable income.
- **Loss Transfer:** Shifting of losses from non-taxable to taxable companies by reducing their profits or shifting income in the opposite direction
- **Cross Border Arbitrage:** Exploitation of different treatments of the same receipt/ payment in different countries. Treaty shopping is a specific manner of cross border arbitrage in which transactions are designed to take undue advantage of treaty between source country and another third country not being the resident country of the taxpayer which do not provide for anti-treaty shopping provisions to avoid taxes.
- Establishing business in an exempt sector with main object not being business but taking advantage of exemption. In this case they also misuse by transferring the profits of non-exempt business to exempt business and claim loss in former business.
- **Shifting of Tax Base:** Shifting tax liability from high tax base to low tax base. For ex. Transferring assets from husband's name to wife's name which is widely prevalent in India.
- **Tax Havens:** there is no precise definition of tax haven. OECD initially defined as

region with less tax or no tax or with less transparency, less effective management. But the list of tax havens is given by OECD from time to time. These havens are misused by corporate by incorporating their company there. In many havens tax is exempt. For ex. Cayman island.

7.3 Once again, as the line between tax planning and tax avoidance is imprecise, one needs to understand the context in which financial affairs are arranged. For instance, tax arbitrage may be a part of government policy for instance the government may be providing favourable rates of taxation for encouraging high investment in a particular sector. In such a scenario what needs to be seen is whether a particular arrangement is actually resulting in high investment in the sector or is providing a limited benefit of favourable tax rates to the taxpayer. In essence, tax arbitrage that is contrary to the legislative purpose or intent becomes tax avoidance.

7.4 Further there is a greater possibility of tax avoidance when there is no conflict of interest between parties involved e.g. related party transaction, for which it is easier to arrange affairs in a manner that they adhere to legal requirements at the same time exploit mutually beneficial provisions.

7.5 Some common indicators that a tax mitigation effort may be one of tax avoidance are:

- Complex arrangement with no commercial rationale
- Circularity with no commercial nature
- Steps inserted or intermediaries introduced in a series of transactions to attempt to break links in a chain and hide essentially the circular nature of arrangements
- Technically correct transaction, however which in effect is defeating the substance and purpose of the tax legislation. However, decisions of the Apex Court must be kept in mind in such cases to bring out how an arrangement is of tax avoidance and not tax planning
- Use of known tax havens, loss making companies, exempt bodies without any apparent commercial rationale

7.6 It can be seen that tax avoidance will cover cases of not paying taxes, paying less taxes or deferment of taxes. The relationship between the form and substance and how it has evolved in tax legislation and litigation becomes crucial in this regards. As already discussed, UK courts only recognise 'substance over form' in limited circumstances, e.g. *must be intermediate step in complex transaction, inserted only for avoidance purposes and whole transaction must be partly motivated by tax avoidance*. The Apex Court in India has also held that tax planning is legitimate means of arranging financial affairs, provided dubious means are not being employed for avoidance of payment of taxes. Therefore it is important to take a rational view in determining cases of tax avoidance. Marshaling of facts relating to all aspects of a transaction or a particular state of financial affairs is imperative to establish that the purpose of the same is tax avoidance.

8. TAX AVOIDANCE IN INTERNATIONAL TAXATION

8.1 Globalization has affected the economic scenario, business activities and taxation environment all over the world. The increasing participation of multinational groups in economic activities of the country has given rise to many new and complex issues emerging from cross border transactions. When a taxpayer e.g. a non-resident Indian or a multinational company has its interests or businesses spread across multiple jurisdictions, then at times separate and specific provisions, as against the case of taxpayers who are resident in India, may be required to prevent tax avoidance due to multiple tax jurisdictions coming into play. Due to the involvement of multiple tax jurisdictions, multiple tax structures and transactions and wider scope and span of business and corresponding complexities, the manner and nature of tax avoidance may

also be different than as in the case of resident taxpayers.

8.2 As in domestic taxation, the dividing line between a transaction with a commercial purpose and one with no such purpose in cases of multi-national entities is not precise. While, like in cases of domestic tax avoidance, fact finding on the lines discussed above is also critical in cases of international taxation, specific provisions are often brought in to addresses cases of tax avoidance that span multiple tax jurisdictions.

9. ANTI-AVOIDANCE PROVISIONS

9.1 Tax avoidance in general may be controlled by General Anti-Avoidance Rules ('GAAR') or Specific Anti Avoidance Rules ('SAAR'). Both the methods have their strengths and limitations. Specific Anti Avoidance Rules are provided for, by specific provisions of tax legislations–domestic tax laws or tax treaties.

9.2 Specific Anti-Avoidance Rules means the enactment of specific provisions in the domestic law of any country or treaty, which target precise tax abuses or unintended tax benefits. Specific anti-avoidance rules "SAAR" is applied to close domestic tax loopholes and indirect violations of tax laws. For example sec 14A was inserted in Income-tax act 1961 by the finance Act 2001 with retrospective effect from 1-04-1962 to disallow the deduction of expense in respect to earn the income that is exempt from income-tax. Certain aspects of tax avoidance have also been controlled legislatively by the provisions of Section 40A(2) of the Act.

9.3 Further, Sections 92 and 93 of the Act provide special provisions relating to avoidance of tax in transactions with non-residents and specific anti-avoidance measures are brought in by various means, for instance Transfer Pricing provisions are incorporated in the Act to ensure that profits between related parties/ associated enterprises in different jurisdictions are shared on equal lines.

9.4 Another means by which tax avoidance issues are addressed in the Indian Income-tax Act, at the preliminary stage is by pre-determination of taxation issues by tax authorities (e.g. by Authority for Advance Ruling). In fact a condition for an application to be admitted under Section 245R (2) is that, the transaction should not be *prima facie* designed for tax avoidance.

9.5 Disclosure requirements that are mandatory also have a purpose to provide tax authorities with information about complex financial arrangements with tax avoidance implications.

9.6 However, often such measures do not provide a comprehensive mechanism to deal with tax avoidance. To bring in the same major legislative provisions in terms of General Anti Avoidance Rules ('GAAR') have been brought in, in the Income-tax Act, 1961

10. GENERAL ANTI AVOIDANCE RULES ('GAAR')

10.1 From 1.4.2017, the provisions of General Anti-Avoidance Rule ('GAAR') embodied in Chapter X-A (Section 95 to Section 102) of the Act are applicable. GAAR is a wide-ranging legislative measure intended to combat aggressive tax avoidance. As already discussed, judicial authorities while upholding legitimate tax planning have targeted sham transactions and use of colourable devices to obtain illegitimate tax benefits. However, these decisions were rendered in the particular factual context of the case and no broad principles were laid down. GAAR is on the other hand a comprehensive legislative measure that empowers tax authorities to not only target clearly sham transactions and use of dubious means such as colourable devices, but also counter the abusive elements of arrangements that otherwise appear to be legally valid. Under GARR the focus is on purpose (i.e. whether the arrangement was entered into with the main purpose of obtaining a tax benefit?).

10.2 Largely seen in the context of cross-border arrangements, GAAR can also apply

to routine day-to-day transaction such as corporate restructuring. Under the law, GAAR can be invoked only if the tax authorities can demonstrate that:

- The taxpayer has entered into an arrangement
- A tax benefit arises from the arrangement
- The main purpose of the arrangement is to obtain the tax benefit
- One or more tainted elements (set out in the law) are present in the arrangement

10.3 While the above elements are broadly worded, they nonetheless carry very specific meanings and are also subject to rules of statutory interpretation. Thus a step-by-step and precise analysis of each of the above stages needs to be undertaken, in light of the business and commercial implications of the arrangements, to identify cases where GAAR can apply. The primary motive is to address arrangements that are only 'tax driven' and have little or no commercial rationale.

10.4 Rule 10U of the Income-tax Rules provides for certain exclusions from the provisions of GAAR. For instance, there is a monetary threshold of Rs. 3 crores for the applicability of GAAR. The threshold is applicable for each assessment year. In general Foreign Institutional Investors (FII) and Foreign Portfolio Investors (FPI) are exempt from the applicability of GAAR.

10.5 Section 95 of the Act dealing with the applicability of GAAR contains a non-obstinate Clause and therefore these provisions can be applied irrespective of any other provision of the Act. On applying the tests listed under this Chapter if an arrangement is declared an impermissible avoidance arrangement, the consequence in relation to tax arising therefrom may be determined subject to the provisions of the Chapter X-A of the Act. The consequences of an arrangement being declared impermissible avoidance agreement are discussed in Section 98 of the Act. The consequences can include denial of tax benefit or a benefit under a tax treaty and shall be determined in a manner that is deemed appropriate. Section 98 further lists down some ways in which the consequences are determined. It clearly specifies that the same is an illustrative list (i.e. the manner of determining the consequences is not limited to what is mentioned specifically in Section 98). For instance, some of the consequences listed in Section 98 are as below:

- Disregarding, combining or recharacterising any step in, or a part or whole of, the impermissible avoidance agreement
- Treating the impermissible avoidance agreement as if it had not been entered into or carried out;

10.6 GAAR checks unacceptable loss of tax revenues through methods perceived to be improper or against the spirit of the law. They assume that transactions entered for reducing tax, contrary to the intention of the legislative body or Parliament should be discouraged. A statutory GAAR is not a revenue-raising measure, but an attempt to protect the tax base established by parliament without expanding it. It allows a purely tax-driven transaction to be disregarded or reconstructed by the tax authorities.

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CHAPTER

21

Making of Quality Assessments

1. INTRODUCTION

1.1 Assessment of income is the most important function of Income-tax Department and the most crucial role performed by Assessing Officers. All subsequent activities such as collection and recovery of taxes, penal measures start from assessment proceedings. Assessment order is, thus, the foundation stone for all future litigations, penal action and ultimate collection of taxes. The process of assessment commences with the issue of preliminary notice calling for return or other details or with the filing of the return and culminates with the final determination of tax liability. The scope of the expression 'assessment' may further include post-assessment actions, which have a direct bearing on final determination of tax liability, or an action which may arise as a logical consequence of the assessment.

1.2 As an assessment order is the first stage on which all subsequent tax collection, penal action depends, it is imperative that the same is made with utmost care, is error free and properly justifies the views of the Department regarding the leviability of taxes. However, an assessment order is merely an end product and though it is important that the order is drafted very carefully, it is equally important that each and every step taken by the AO in the course of the assessment proceedings is by itself legally justified, in accordance with the prescribed procedure and law and adheres to the highest quality standards.

2. NATURAL JUSTICE AND ASSESSMENT PROCEDURE

2.1 The principles of natural justice are enshrined in two Latin maxims - nemo judex in causa sua and audi alteram partem. Translated literally, these maxims mean respectively that - (i) no one can be a judge in his own cause, and (ii) let the other side be heard. In other words, the first is to the effect that no one should have personal interest in a case before him, and the second that no one should be condemned unheard. Thus, not only the assessment order, but also every action taken by the AO in the course of assessment should stand the test of appeal on the grounds of impartiality and

fairness. Negatively, these two rules may also be called rules against bias and arbitrariness.

2.2 The assessment proceedings are quasi-judicial proceedings and, therefore, every action of the AO is tested on the touchstone of natural justice. The making of an assessment involves two parts, *viz.* procedural and substantive. The AO owes his jurisdiction and his powers to the provisions of the Act and therefore his every action must conform to the procedure laid down in the Act read with the Rules and the CBDT Circulars. All his actions undertaken during the course of assessment must pass the test of procedural fairness. The non-observance of principals of natural justice or the prescribed procedure is itself a prejudice to the assessee. Therefore, any act or a decision in the course of an assessment on any particular point, which is adverse to the assessee, must be made only after bringing that point duly to the notice of the assessee and hearing him on it. The assessee must be given reasonable opportunity of being heard. He should be given reasonable time for answering the queries raised and for rebutting the negative inferences drawn by the Assessing Officer from the submission made by the assessee. This is critical because a large number of assessments where good investigation has been done do not stand the test of appeal, because the appellate authorities set aside or annul the assessment orders on 'grounds of failure to meet the principles of natural justice'.

2.3 The principle of audi alteram partem has been well recognised by the legislature and a large number of procedural provisions in the Act have expressly incorporated this principle. For example, Chapter XVI of the Act dealing with the procedure for assessment incorporates this principle in sub-Section 3 of Section 142 which reads as:

> "(3) The assessee shall, except where the assessment is made under s.144, be given an opportunity of being heard in respect of any material gathered on the basis of any inquiry under sub-Section (2) (or any audit under sub-Section (2A) and proposed to be Utilised for the purposes of the assessment."

Similarly Sections 142(2A), 144A, 154, 158, 163, 170, 171, 263 and 275 etc., also specifically provide for hearing. The courts have, however, held that even where the statute does not provide for hearing, the principles of natural justice demand that opportunity of being heard should ordinarily be given unless it is implicitly or expressly excluded. However, 'hearing' means reasonable hearing and 'fairness' does not require plurality of hearings. The Supreme Court observed as under in the celebrated Kraipak case:

> 'Rules of natural justice are to secure justice and to prevent miscarriage of justice. They supplement the law and do not supplant it.'

2.4 Prima facie indications of 'fairness' on the part of the AO are: i) adequate notice, ii) opportunity of hearing, and iii) speaking order. The assessment order must be a speaking order. A speaking order is one in which each and every point of dispute has been properly dealt with. The order itself bears evidence to 'due application of mind' on the part of the authority. Due application of mind has been judicially defined to mean that there is something in the order that shows that the point or the issue has been duly considered by the AO after taking into account the objections of the assessee.

3. THE STATE BANK OF PATIALA CASE

3.1 In the landmark case of *State Bank of Patiala and Ors. vs. S.K. Sharma* (1996 3 SCC (364)) the Supreme Court has reviewed the entire gamut of case law on natural justice starting with the classic case of *Ridge vs. Baldwin* and culminating with

the decision of Constitution Bench in the case of Managing *Director ECIL vs. B. Karunakar* (1993) 4 SCC 727. The court observed:

> "Justice means justice between the parties. The interest of justice equally demand that the guilty should be punished and that technicalities and irregularities which do not occasion failure of justice are not allowed to defeat the ends of justice. Principles of natural justice are but the means to achieve the ends of justice. They can not be perverted to achieve the very opposite end".

Jeevan Reddy J, quoted the following observation of the Supreme Court of Canada:

> "Principles of fundamental justice guarantee fair procedure but do not guarantee the most favourable procedure that can be possibly imagined."

3.2 In this decision the court gave precise guidelines, as under:

- It should be ascertained whether the provision violated is of a substantive nature or procedural in character. A substantive provision is normally to be complied with in full and the theory of substantial compliance or the test of prejudice would not be applicable in such a case.
- In the case of violation of procedural provisions, the position is this: procedural provisions are generally meant for affording a reasonable and adequate opportunity to the person proceeded against. They are, generally speaking, conceived in his interest. Violation of any and every procedural provision cannot be said to automatically vitiate the enquiry held or order passed.
- Except in cases falling under- 'no notice', 'no opportunity' and 'no hearing' categories, the complaint of violation of procedural provision should be examined from the point of view of prejudice, *viz.* whether such violation has prejudiced the person in defending himself properly and effectively. If it is found that he has been so prejudiced, appropriate orders have to be made to repair and remedy the prejudice including setting aside the enquiry and/ or the order of punishment. If no prejudice is established to have resulted there from, it is obvious, no interference is called for.
- There may be certain procedural provisions, which are fundamental in character whose violation is by itself proof of prejudice. The Court may not insist on proof of prejudice in such cases.
- In the case of a procedural provision that is not of a mandatory character, the complaint of violation has to be examined from the standpoint of substantial compliance. Be that as it may, the order passed in violation of such a provision can be set aside only where such violation has occasioned prejudice to the person. In the case of violation of procedural provision, which is of a mandatory character, it has to be ascertained whether the provision is conceived in the interest of the person proceeded against or in public interest. If it is found to be the former, then it must be seen whether the person has waived the said requirement, either expressly or by his conduct. If he is found to have waived it, then the order cannot be set-aside on the ground of the said violation.
- If on the other hand, it is found that the person has not waived it or that the provision could not be waived by him, then the court or tribunal should make

appropriate directions (including the setting aside of the order), keeping in mind the approval adopted by the Constitution Bench in B. Karunakar. The ultimate test is always the same, *viz.* the test of prejudice or the test of fair hearing, as it may be called.

- While applying the rule of audi alteram partem (the primary principle of natural justice) the court/ tribunal/ authority must always bear in mind the ultimate and overriding objective underlying the said rule, *viz.* to ensure a fair hearing and to ensure that there is no failure of justice. It is this objective which should guide them in applying the rule to varying situations that arise before them.
- There may be situations where the interests of state or public interest may call for a curtailing of the rule of audi alteram partem. In such situations, the court may have to balance public/ state interest with the requirement of natural justice and arrive at an appropriate decision.

4. THE PRINCIPLES OF NATURAL JUSTICE IN THE CONTEXT OF PROCEEDINGS UNDER THE IT ACT

4.1 In the context of Income-tax proceedings, the principles of natural justice can be stated as follows:

1. The AO must not have any interest in a case over which he has the jurisdiction. If the assessee is somehow related to the assessing officer, he should duly bring it to the notice of the superior authorities and have the case transferred from his jurisdiction. This upholds the maxim that, 'Justice must not only be done but it must be seen to be done.'
2. It is not sufficient to ensure that the prescribed statutory notices are duly issued and served on the assessee. The notice must provide for sufficient time so that the opportunity granted can be said to be a reasonable opportunity of hearing.
3. Any evidence, be it a statement, document or a report from any officer or agency or any private inquiry, should be used in making the assessment after its contents are duly intimated to the assessee and he is given an opportunity to rebut the same.
4. Opportunity for hearing should not be a mere formality. It should be adequate, real and substantive. For instance, where an assessee is required to explain certain entries in a seized or impounded diary, he should be given copy of the relevant pages of the diary and then should be granted sufficient time for furnishing his explanation.
5. Where the AO proposes to use an oral testimony of a witness, he should provide a copy of the testimony to the assessee and also give him an opportunity to cross-examine the witness if requested by the assessee.
6. Where, however, an assessee asks a particular witness to be produced, the AO must issue summons on the said witness and allow the assessee to examine the witness and thereafter himself cross-examine the witness.
7. The written or oral submission/ explanation of the assessee should not be ignored and if the explanation call for further inquiry to be made, further evidence to be collected, the same should be done.
8. Where the assessee gives oral explanation, it should be duly recorded in the order-sheet and the assessee's signature may be obtained for record. Where the Section provides for reasonable opportunity of being heard; the AO must give the assessee

an option of oral and personal hearing. It is for the assessee to avail of the opportunity either to appear personally or through his authorized representative.

9. Where the assessee does not comply with the statutory notice and the AO proposes to make an ex-parte assessment, and the AO is in possession of evidence relating to fraud, manipulation of accounts or any other finding which will be used against the assessee in concluding the assessment, the AO should not pass the assessment order without giving the assessee a specific opportunity of rebutting the evidence. Despite the specific provisions of Sec 142(3), the courts have not accepted the plea that since the assessee did not comply with the statutory notices and the exparte order had to be made, there was no need to give an opportunity to explain the material available with the Department. The courts have held that where a statutory notice was not accompanied by a show cause notice enumerating the evidence to be used against the assessee, the AO should, in the event of non-compliance, give a further opportunity and communicate the content of the incriminating evidence. Thus a final show cause notice even in cases of ex parte assessments must be given to the assessee.

10. Any decision of the Tribunal or Court or a circular of the CBDT which the AO proposes to use against the assessee should also be communicated to the assessee for his comments.

11. Any decision relied on by the assessee should be discussed and properly examined in the order - and, if necessary distinguished. Likewise, where the assessee challenges the jurisdiction on any count or raises the question of limitation, it should not be ignored, but should be properly dealt with reference to the facts on records. This is even more crucial in cases of reopening where the assessee's challenge the reassessment on jurisdictional grounds or allege that the reasons recorded do not lead to a belief that there has been an escapement of income. In such cases as held by many Courts, such objections should be specifically dealt with, preferably by a separate speaking order. Disposal of such objections by a separate speaking order has been made mandatory by several High Courts notably the Bombay High Court.

12. Lastly, where an assessee makes an application for inspection of case records or for making copies of seized or impounded documents etc. it should be allowed in accordance with Board's instructions in this regard, and then be given sufficient time to file his explanation.

5. ASSESSMENT PROCEDURE

5.1 Notices: An assessment proceeding starts with valid service of notice calling for the return or with the filing of the return by the assessee. Until this event occurs there is no proceeding pending for that particular assessment year. Thus, it should be ensured that where no return has been filed by the assessee, a notice under Sections 142(1) or 147 is validly served within the limitation prescribed under the Act. The acknowledgment of service should be pasted on the back of the notice or placed on record, and this fact should be duly recorded on the order-sheet. Subsequently when the assessment is taken up a notice under Sections 143(2) or 142(1), as the case may be, should be served giving adequate time to the assessee. Any case which is picked up for scrutiny should be fixed at the very earliest so that there is sufficient time available for collecting evidence, giving assessee adequate opportunity and drafting the assessment order. Assessments where proceedings begin belatedly suffer from

lack of time as the limitation date approaches. This results in a 'hurried assessments' where additions are made on the basis of incomplete or insufficient investigation. It is difficult for such additions to stand the test of appeal.

5.2 Processing of Returns: The AO must ensure that the return is not defective *u*/s 139(9) or invalid *u*/s 140. He should there after process it as per the existing provisions and procedures under Section 143(1) of the Act.

5.3 A number of reports and certificates from the auditors/ accountants are required to be filed under the various provisions of the Act. The AO should ensure that these are filed along with the return in the submissions, and should carefully scrutinize them, along with similar reports/ records of earlier years. In a case selected for scrutiny, the AO should note any abnormalities or discrepancies and include specific questions in regard to them in the questionnaire to be issued along with the notices *u*/s 143(2)/ 142(1). Most significant preliminary clues for investigation for assessment are contained in the return and documents required to be filed by the assessee. For instance increase in turnover with a disproportionately large increase in expense e.g. commission payments could indicate a possible line of enquiry. Similarly a sharp increase in unsecured loans, decline in gross profit or net profit or introduction of fresh capital in the case of the company would clearly call for investigation in the course of assessment. The list of such abnormalities/ discrepancies is endless. The AO should familiarize himself with the nuances of the nature of business carried out by the assessee, and then examine the Trading and Profit & Loss accounts and audit reports carefully for any items that call for investigation.

5.4 The Act has given specific powers to the AO to enable him to carry out investigation effectively. These powers are not unfettered and must not be exercised arbitrarily or in a biased manner. It may also be emphasized that the basic object of investigation is to unearth facts, and not surmises or opinions unless the opinion is an expert opinion that establishes facts.

5.5 As already emphasized, cases should be fixed at the very earliest. The initial fixation of cases is by way of service of Section 143(2) notice. A questionnaire should either accompany the same or be sent at the earliest posing specific queries based on the information given in the return and other documents filed along with it. Queries must be focused and not be in the nature of vague or roving enquiries.

5.6 Though the assessee does not have a vested right to get adjournment, it has been held that where an application for adjournment is made well in advance, the AO should consider it, and if the reasons are sound it should be allowed. However, where the assessee seeks adjournment for frivolous reasons or repetitively, the AO will be well within the law in rejecting the same. While granting adjournment on an application by the assessee or where the matter is partly heard and the AO adjourns the same for another date for further hearing, appropriate noting must be made on the order sheet and the signatures of the representatives of the assessee should be taken.

5.7 Procedure for Assessments under Section 143(3)

Some of the key procedural aspects of the manual assessment proceedings are as below:

1. The AO must hear the assessee and consider the evidence produced by him and record the gist of the same in the order sheet.
2. The AO may adjourn the hearing to another date and take up the proceedings on the subsequent date to which the case is adjourned.
3. The AO may require the assessee to produce further evidence on specific issues

on the specified date to which the hearing is adjourned.

4. The AO can take into account all or any of the material that he has gathered and use it for the purpose of making assessment provided he has given a reasonable opportunity to the assessee, for furnishing his explanation wr.t. each such item of the material being so used.

5. The AO should pass a speaking assessment order and determine income as also the tax payable in the body of the assessment order itself. The assessment order should be passed within a reasonable time after conclusion of hearing.

6. Where the AO is transferred, the new incumbent must give an opportunity for hearing to the assessee, even where his predecessor had fully heard the matter.

7. Assessment order together with ITNS 150 and the demand notice should be issued immediately either through the Notice Server or by R.P.A.D. The date of service of the demand notice should be recorded in the order sheet and acknowledgement should be pasted on the office copy of the demand notice. With the shift towards e-assessment, it must be ensured that the order is passed through system timely and sent to the correct email address as submitted by the assessee.

8. Often, AOs do not mention the specific Sections under which interest for late filing of return or of advance tax or for deferral of installments for payment of Advance-tax, is charged. Even though the charge of interest under Sections 234A, 234B and 234C is mandatory and the AO has no discretion to waive or reduce it, the quantification of interest could still be made a subject matter of appeal. Therefore, the AO must indicate the particular Section under which the interest is charged.

9. While making an assessment, the AO should not only be guided by the provisions of law and the facts of the case but also give due regard to:
   - CBDT Circulars
   - Ratio of any direct decision of the jurisdictional High Court and of Supreme Court
   - Directions issued by the Joint/ Addl Commissioner under Section 144A of the Act
   - Directions of Authority for Advance Ruling, Settlement Commission if applicable and the Competent Authority under the DTAA
   - Directions issued by the Commissioner or Chief Commissioner under Sections 263, 264, 273A of the Act if any
   - Giving effect to the orders of CIT (Appeals) or the ITAT, for the assessment year if any (especially w.r.t. issues that have a cascading effect)

6. USE OF POWERS *U/S* 131

6.1 Summons *u/s* 131 can be issued by the AO only during the pendency of any proceeding including assessment proceedings. Where it is urgently required to issue summons to a witness and no proceedings are pending, the AO should take the help of the Directorate of Investigation. The ADIT/ DDIT (Investigation) has the powers to issue summons (by virtue of sub-section 1 of Section 131 of the Act) notwithstanding that no proceedings are pending before them.

6.2 Reasons must be recorded in the order sheet before issuing summons. In other words, there should be evidence on record to satisfy

the courts that there was due application of mind by the AO. It has been held by the courts that application of judicial mind is essential for invoking the extra-ordinary powers *u/s* 131. 'Application of judicial mind' can be evidenced only from the notings of the AO.

6.3 Though Section 13 of the Indian Oaths Act 1873 provides that any omission to take an oath would not invalidate the evidence, it would still be proper if an oath is administered and it is duly noted before the narration of the statement of a person begins. It would also be better if the main statement is written out not in the hand of the AO but in the hand of the person giving the statement. This is to ensure that the person giving the statement does not say at a later stage, that the statement recorded by the AO was not true. As far as possible, the statement should be recorded in the language in which the assessee or the witness gave his deposition. If it is recorded in English, the person giving the statement must state in his own hand that he or she understands English language and also give his educational qualifications. The person giving the statement must then sign each page of the statement.

6.4 In case any documents are impounded in the course of the proceedings *u/s* 131, the AO must record detailed reasons before impounding the documents. If no such reasons are recorded, the impounding is invalid. Likewise, all requests seeking extension for retention of impounded documents must give specific reasons for extension so that the Commissioner may apply his mind. Though the reasons need not be communicated to the assessee, the fact of approval by the Commissioner must be communicated immediately on receipt of such approval.

6.5 Section 131 also empowers the AO to issue commissions. This power can also be Utilised to obtain a report relating to any vital fact - be it the site report or examination of witnesses etc- from the officer under whose jurisdiction the site or witnesses are situated. For this purpose, the officer has the powers of the court as prescribed under Rule 19 of Order XVI of the Civil Procedure Code. The procedure for examination of witnesses etc. under the commission is given in Rules 1 to 8 of Order XXVI of CPC. The officer issuing commissions and the officer discharging the commission should strictly abide by these rules. The report of the exercise should also be given to the assessee.

6.6 The purposes for which a commission can be issued are enumerated in Section 75 of CPC. One of the purposes for which the commission can be issued is 'to hold a scientific, technical or expert investigation'. Relying upon this, in *CIT v. Basana Rani Saha* (2000) 243 ITR 780, the Gauhati High Court has held that the AO can seek expert opinion of the Valuation Officer about the cost of construction of a building by issuing commission *u/s* 131. The assessee is entitled to be represented through a registered valuer in connection with any matter relating to valuation of any asset (Section287A). If the AO is not satisfied with the valuation by the registered valuer, he should refer the matter to the government valuer for his opinion. An expert opinion should not be rejected without obtaining another expert opinion contradicting it. As above, Sec 131 commission can be employed for this purpose.

7. POWER TO CALL FOR INFORMATION *U/S* 133

Section 133 empowers the AO to call for specific information from the assessee. Information can be also sought in a case where no proceeding is pending provided prior approval of the Commissioner is taken. Under this Section, the AO can call upon any assessee to furnish details such as a statement of the names and addresses of all persons to whom he has paid in any previous year - rent, interest, commissions, royalty, brokerage etc. together with particulars of all such payments. The AO can also require

any person including the bank to furnish specific information including the statement of accounts etc.

8. POWER OF SURVEY *U/S* 133A

Survey *u/s* 133A is another important tool of investigation. By an amendment of the Section vide Direct Taxes Laws (Amendment) Act 1987, certain lacunae have been removed and the powers have been further expanded. This has been spelt out in the Board's Circular No. 551 dated 23.1.90.

9. TAX AUDIT REPORT *U/S* 44AB

9.1 Section 44AB was inserted in the Income-tax Act by the Finance Act 1984. Under this Section every assessee engaged in any business and having turnover or gross receipts exceeding Rs. 40 lacs (now enhanced to Rs. 1 Crore, except in cases of assessees opting for presumptive taxation *u/s* 44AD where the limit is Rs. 2 Crores) is required to get the accounts audited by a chartered accountant and submit the tax audit report (TAR, for short) before the due date for filing the return of income under Sec 139(1). In the case of a professional similar report is required if the gross receipts from the profession exceed Rs. 10 lacs (now enhanced to Rs. 50 Lacs)

9.2 The audit report in form 3CD/ 3CE gives information about certain items of income/ expenses appearing in the financial statements. Moreover, the auditors are also required to express opinion on certain items of income/ expenditure. For instance, the auditors need to express such opinion on items *viz.* (i) inadmissible amount of salary or interest to partners under sec 40(b), (ii) inadmissible expenditure under sec 40A(3), (iii) depreciation allowable under the Act, (iv) deduction admissible under Chapter VI-A, (v) profits chargeable to tax under sec 41,etc. Thus TAR places responsibilities on auditors and will requiring them to report on almost all items relating to computation of income of the assessee. Moreover, in many cases the auditors also give qualifying remarks regarding non-compliances to provisions etc. that can be starting point of specific enquiries.

9.3 Although forms 3CA/ 3CB relate to audit report to be given in respect of financial statements of the entity audited by them/ other statutory auditors, statement of particulars annexed to such report in Form 3CD contains many Clauses such as (i) any other income note credited in the Profit & Loss Account (ii) brought forward losses/ depreciation (iii) Chapter VI-A deduction under Income-tax Act, etc. The auditors are also required to report about (i) penalty or fine paid for violation of any law for the time being in force, (ii) any other penalty or fine, (iii) expenditure incurred for any purpose which is an offense or which is prohibited by law and such other matters concerning other laws.

9.4 All this information gives significant preliminary details relevant to the AO. The computation of income submitted by the assessee must be cross verified with the allowable deductions, disallowances specified in the TAR.

9.5 Particulars relating to some of the items, *viz.* (i) amount inadmissible *u/s* 40 (b), (ii) amounts admissible under Chapter VI-A (iii) amount admissible *u/s* 40B etc. cannot be given unless the assessee has prepared his return of income for the relevant year. Therefore, if the return of income is not ready before the date of giving tax audit report, the auditors will have to clearly state that the relevant information is not given. Further, if the auditors have relied upon the working made by the assessee which they have not been able to verify fully, the auditors give a qualifying remark stating that the same has not been fully verified.

9.6 The auditors are expected to study past assessment/ appellate orders in order to report on some of the Clauses relating to (i) working of allowable depreciation, (ii) profit chargeable

to tax *u*/s 41, (iii) brought forward losses and unabsorbed depreciation, etc. The report may qualify that the figures are likely to be revised on final decision in assessment, rectification, revision or appellate proceedings which may be pending for earlier years. In all such cases all pending rectifications, appeal effects etc. should be carried out before finalizing the assessment.

9.7 Notes to accounts and significant accounting policies usually bring out exceptional circumstances such as claim for deduction or claim any exemption in respect of any income by placing reliance on any judicial pronouncement while finalizing the return of income. Therefore, notes in Form 3CB/ 3CD are carefully worded and must be perused thoroughly to identify such typical items for further investigation as to the validity of such a claim.

9.8 In respect of some items *viz.* (i) payment made otherwise than through account payee cheques, (ii) salary to working partner, whether allowable or not, (iii) date on which any asset is put to use, etc. sufficient evidence may not be available. In such cases, the auditors may state that such information cannot be given in the absence of the required evidence. Where two views are possible, the auditors may express their opinion and support the same by citing a judicial pronouncement. On controversial issues, however, the auditors are not bound to cite judicial decisions to the contrary. All these are matters fit for further enquiry. The AO should exercise due care and bring out the correct legal as well as factual position. For instance regarding the date of put to use is not clear, then additional supporting evidence can be called for especially in cases where additional depreciation or depreciation at a higher rate is being claimed.

9.9 It is amply clear that the TAR and in particular Form 3CD have been designed to elicit vital information relevant for assessment in case of business or profession falling in higher income brackets. The AOs dealing with high income cases and cases of companies must familiarize themselves with the contents of the TAR.

10. QUALIFICATIONS IN AUDIT REPORTS

10.1 While giving audit report the auditors have to ensure compliance with accounting standards issued by the ICAI & ICDSs issued by the Govt. ICDS-1 notified *u/s* 145 of the Act (disclosure of accounting policies) recognises that the major consideration governing the selection and the application of accounting policies are (i) prudence, (ii) substance over form and (iii) materiality. Therefore, while examining particulars in Form 3CD, these aspects should be kept in mind. In particular, the Auditors consider the aspect of materiality while giving notes in the audit report. As already discussed, the auditors also rely upon judicial pronouncements while giving the particulars in the report, and can make specific mention of cases relied upon. Such cases may have been accepted by the Revenue or further appeal might have been preferred. Such cases may not be binding on assessee in a specific jurisdiction or the facts in the assessee's case may be distinguishable which should be examined and established during the course of assessment.

10.2 Needless to say that the TAR read with statutory audit report and the return would throw up various lines of enquiry for investigation for making assessment. As already stated, it is crucial that the Assessing Officer takes note of the qualifications made by the auditors. These qualifications can be pointers to the defects in accounts, e.g. maintenance of basic registers or stock valuation or non-compliance of statutory requirements e.g. filing of report in Form 3CEB. Every qualification must be carefully examined to identify areas of shortcomings in the assessee's financial affairs and possible tax implication. As per the statutory provisions in the Companies Act relating to qualifications in the auditors report; if the auditors are required to answer any of the

statutory affirmation in the negative or with the qualifications, their report shall state the reasons for such answer. It is, therefore, necessary for the auditors to give reasons for any qualifications in his note. Such qualifications may be contained not only in the tax audit report but also in the statutory audit report prepared by the statutory auditors under the Companies Act and, therefore, it is imperative for an AO to examine both.

11. COLLECTION AND USE OF EVIDENCE

11.1 In the course of assessment several kinds of evidence may surface. Broadly speaking, evidence would fall in any of these categories:

- Evidence produced by the assessee.
- Evidence collected by the AO through open or closed inquiries.
- Evidence, which is available in the public domain.
- Evidence collected from other agencies, departments of the Government, etc.
- Evidence found through third party's accounts, returns, assessments etc.
- Evidence received from a tax department of a foreign country under the DTAA.

Every AO, in the course of assessment, would come across evidence collected or received from these sources. After the collection of evidence, its appraisal and procedure for using the evidence forms the core of assessment work.

11.2 Evidence Produced by the Assessee

11.2.1 The most basic and preliminary evidence tendered by the assessee under due verification and affirmation is the return of income and its enclosures. These form the starting point of any enquiry. Therefore, all the columns of the return and its various enclosures should be carefully scrutinized. Wherever required, statutory audit or tax and it report is also filed. The AO must ensure that the return and all other documents and statements filed along with it or subsequently in the course of assessment proceedings are duly authenticated by the assessee or by his power of attorney holder.

11.2.2 As already discussed, the return and its main enclosures, namely the Annual Accounts, the statutory Auditor's Report, the TAR, the Directors' Report to the shareholders, the Annexures and Schedules attached to these reports contain crucial information which should be carefully studied beforehand. Many hints and clues, no matter how understated or downplayed, are available in these, which are indicative of further lines of enquiries.

11.2.3 Apart from evidence statutorily required to be maintained and tendered by the assessee, the assessee may produce additional evidence in the course of the assessment. Such evidence should be investigated by the AO with a view to check its veracity, relevance and adequacy. If the AO has material to refute such evidence he must confront the assessee with such material and discuss his findings in the assessment order.

11.3 Evidence Collected by the AO

11.3.1 The most commonly used provision for information collection during the course of assessment is by calling for information directly from the assessee under Section 142(1) of the Act. Section 142(1)(ii) of the Act enables the AO to require the assessee:

- 'To produce, or cause to be produced, such accounts or documents as the AO may require', or
- 'To furnish in writing and verified in the prescribed manner information in such form and on such point or matters (including a statement of all assets and liabilities of the assessee, whether included

in the accounts or not) as the AO may require.

The scope of this Section is different from that of Section 143(2), which speaks of 'any evidence which the assessee may rely in support of the return'. The AO should make full use of this provision for gathering evidence that he requires as distinct from what the assessee may choose to produce in support of the return.

11.3.2 Section142 (2) enables the AO to make such enquiries as he considers necessary 'for the purpose of obtaining full information in respect of the income or loss of any person'. The sweep of this provision is wide. It is not confined to the assessment proceedings or to the particular assessee before the AO.

11.3.3 Section 143(3) states that the AO may pass the assessment order after 'taking into account all relevant material which he has gathered'. In other words, the AO must have some material on which to base his judgment or estimate. Even in a case where the account books are rejected, the assessment must have nexus to the material on record. Records, in this context, include past records also which should be referred to for deciding assessment for any year especially w.r.t. recurring issues of addition/ disallowance.

11.3.4 The law on the powers of the AO in collecting evidence and relying on such evidence was settled as early as in 1944 in *Seth Gurumkh Singh v. CIT* (12 ITR 393 at 427). The principles laid down in it were duly approved by the Supreme Court in the case of *Dhakeswari Cotton Mills Ltd. vs. CIT* (1954) 26 ITR 775 at 782. These judgments lay down the following principles:

1. The AO is not bound to rely on such evidence produced by the assessee which he finds to be false or irrelevant. However, he must give detailed reasons why such evidence is false.
2. Where the AO proposes to make an estimate in disregard of the evidence led by the assessee, whether oral or documentary, he should in fairness disclose to the assessee the material on which he is going to base that estimate.
3. The AO is not debarred from relying on private sources of information which he may not disclose to the assessee at all.
4. In case the AO proposes to use the evidence from private sources, he must communicate the substance of such information to the assessee to such an extent as to put the assessee in possession of full particulars of the case he is expected to meet and give him ample opportunity to meet it.

11.4 Evidence that is of Public Nature

There are certain evidences, which are available in the public domain. These could be government public orders, gazette notifications, Board's Circulars and public circulars, by other Departments of the government. Normally the assessee can be presumed to be in the knowledge of such evidence of public nature. However, where the AO proposes to use any such order or a reported decision of a court, he should ideally communicate to the assessee the substance of such order, notification etc. and give him an opportunity to put forward his case.

11.5 Evidence Collected from Other Agencies/ Departments

Evidence may be gathered from other agencies or departments of Government, *u/s* 133, or 132 A etc. Section 132A, provides for requisition of the material from the custody of other authorities. The scope and effect of the provisions have been explained in the departmental Circular No. 179 dated 30.9.1975. It has been judicially held in several cases that 'there must be some material on file which could be recorded as information

on the basis of which the Authorizing Officer can have reason to believe that action *u/s* 132A is called for and this material must have nexus with any of the reasons mentioned in Clauses (a), (b) and (c) of the aforesaid Section.

11.6. Evidence Found in Third Party's Accounts, Returns, Assessments

Where some evidence disclosed by a person other than the assessee in his books of accounts or the return etc. is proposed to be used against the assessee in his assessment, the AO must confront the assessee with such evidence and give him an opportunity of being heard. He may also summon the third party, record his statement and give the assessee an opportunity of cross-examination. In other words, any evidence furnished or sourced from a third party can be used against the assessee only after the assessee has been duly confronted with the same and given a specific opportunity to rebut the same.

11.7. Evidence Received from Tax Department of a Foreign Country

The Double Taxation Avoidance Agreements normally provide for a Clause for exchange of information between the tax authorities of the two countries. Where the AO seeks information from the tax authorities of a foreign country, he must make a specific proposal in this regard and forward the same through his Commissioner to the Foreign Tax Division of the CBDT who alone can correspond with the foreign tax authorities. On receipt of information from the foreign tax authorities which the AO proposes to use in the assessment, he should once again communicate to the assessee the contents of such information and give him a reasonable opportunity for rebutting the same.

12. FRAMING OF ISSUES

Any scrutiny assessment would involve determination of a number of issues of disputed facts, or law or both, depending upon the facts and circumstances of a given case. It is always a goods approach to identify and frame clear issues for consideration, on the basis of the reply to the initial questionnaire, and preliminary hearings. The proceedings thereafter can be narrowed down to the examination of such issues. Even while considering each of the issues so framed, it is advisable to first segregate admitted facts and disputed facts relevant to that issue. Thereafter, evidence relating to the disputed facts (documentary, oral, circumstantial) can be gathered by the AO either directly or from the assessee for a proper appraisal and determination. It must be borne in mind that principles of law can be correctly applied only when facts are properly established.

13. APPRAISAL OF EVIDENCE OR MATERIAL

13.1 The entire exercise of carrying out investigation and collecting evidence for making an assessment is an exercise of establishing facts as distinguished from opinions. Thus, the relevance or the value of the evidence should be judged from only one point of view - whether such evidence goes to establish a fact or at least goes to increase the probability of such a fact. The AO should first establish facts and only then draw logical inferences and search for the correct law applicable to such primary facts or the inferred facts. As observed by the Lahore High Court in the case of *Seth Gurmukh Singh vs. CIT*: "But though the AO has very wide powers and is not fettered by technical rules of evidence and pleadings, there is one overriding restriction on his judgment and that is that he must act honestly on the material, however inadequate, before him, and not vindictively, capriciously or arbitrarily."

13.2 Affidavits: If an affidavit is filed by an assessee and he is neither cross-examined on its content nor called upon by the AO to produce any corroboratory evidence, the rejection of

the affidavit will not be justified. If the AO has any evidence which contradicts the affidavit, the assessee must be duly confronted with the same. The evidentiary value of an affidavit has been discussed by the Supreme Court in the case of *Mehta Parikh & Co.* (1956) 30 ITR 181 (SC). This decision lays down, that if there is no material whatsoever on record for doubting the veracity of the statements made in the affidavit, and if the deponent has also not been subjected to cross-examination for bringing out the falsity of his statements, then doubting the correctness of the statements made in the affidavit is not justified.

13.3 Books of Account: Books of account maintained in the regular course of business are relevant and *prima facie* proof of the entries and the correctness thereof. However, where entries made in the books of accounts go against any averment made by the assessee, it is for the assessee to show that the entries are incorrect. The burden of the proof lies on the assessee to prove that the entries in seized books of accounts showing receipt of on-money in cash are not real receipts [*Debi Burman vs. CIT* (1994) Tax LR 452,456 (Cal)]. In another interesting case of *Vazhakala Estate vs. State of Kerala* (1994) 210 ITR 451,461-62(Ker), in the context of Agricultural Income-tax Act, estimate of income made on the basis of a slip of paper found in the books of account produced by the assessee was held to be justified.

13.4 Loose-leaf Account Books: In general, accounts consisting of loose sheaf of paper do not have the same probative force as bound account books, which are kept in the regular course of business. However, this proposition may not now hold good in a case where the accounts are kept on the computer and hard copies by way of loose sheets of printouts are produced.

13.5 Unregistered Document that is Compulsorily Registrable: Normally an unregistered document that is compulsorily registrable may not by itself constitute sufficient proof, but it can be admitted and made use of as collateral evidence. In the case of *Narsingdas Surajmal Properties (P). Ltd. V. CIT* (1981) 127 ITR 221, 225 (Gauh) it was held that an unregistered lease deed which was compulsorily registrable was admissible to prove the nature and character of lessee's possession as well as to show that he was a tenant in occupation of the demised land on payment of rent. It needs to be mentioned that sham deeds are of no evidentiary value even though they may have been registered.

13.6 Evidentiary Value of Official Records: According to illustration (e) to s.114 of the Indian Evidence Act, the Court may presume that judicial and official acts have been regularly performed. This presumption attached to the correctness of official records cannot be taken away merely by assumptions or suggestions raising doubts.[Capital Talkies v. CIT (1981) Tax LR 1029 Orissa]. In this case, their Lordships have deprecated 'the practice prevailing in the Income-tax Department of issuing orders to the assessee without the signature of the Officer or even bearing the official seal'. It was observed that 'the order sheets should be properly maintained, orders should be duly sealed and signed by the Officer'.

13.7 Following Evidence can also be Used by the AO

1. Findings given by a criminal or civil court on the same facts. The AO, however, is not bound to follow the court decision in a case where he has found additional evidence not considered by the court.
2. Photostat copies have little evidentiary value but if the original is produced along with it, the same may be admitted after duly comparing it with the original document and obtaining due certification.

3. A photocopy of a foreign document can be admitted as evidence provided it is authenticated in the manner prescribed by the Diplomatic and Consular Officers (Oaths and Fees) Act 1948.

4. Tape-recorded conversation can only be relied upon as corroborative evidence of conversation deposed by any of the parties to the conversation. In the case of *Ziyauddin Burhanuddin Bukhari v. Brijmohan Ramdass Mehra, AIR 1975 SC 1788, 1795*, the Supreme Court has laid down the rule in regard to tapes, cassettes, compact discs, etc. produced as evidence, that these are 'documents', as defined by s. 3 of the Evidence Act, and stand on no different footing than photographs. These are admissible in evidence on satisfying the following conditions:

    a. The voice of the person alleged to be speaking must be duly identified by the maker of the record or by others who know it.

    b. Accuracy of what was actually recorded had to be proved by the maker of the record and satisfactory evidence, direct or circumstantial, had to be there so as to rule out possibilities of tampering with the record.

    c. The subject matter recorded has to be shown to the relevant according to rules of relevancy under the Evidence Act.

14. BURDEN OF PROOF/ ONUS

14.1 The burden of proof is the obligation of a party in a trial or dispute to produce the evidence that will prove the claims they have made against the other party. In a legal dispute, one party is initially presumed to be correct and gets the benefit of the doubt, while the other side bears the burden of proof. When a party bearing the burden of proof meets their burden, the burden of proof switches to the other side.

14.2. Sections 101 to 114 of Indian Evidence Act 1872 deal with burden of proof. Section 102 of the Evidence Act provides that the burden of proof lies on that party who would fail if no evidence at all were given on either side. Thus, if an assessee claims that money or bullion found in his possession at the time of the search or survey does not belong to him but some one else, the onus is on him to establish it, because the ordinary presumption is that he is the owner as the money etc., was found in his possession. Similarly, in all cases where a particular receipt is sought to be taxed as income, the initial onus is on the AO to prove that it is taxable. Where, however, the assessee claims exemption, the burden is on the assessee to prove it to be exempt. Similar is the position in case of allowances, deductions, claims of loss, etc. Similarly, where there is a statutory rebuttable presumption against the assessee, as in case of cash credits etc., under sec 68 or unexplained investment u/s 69, the initial burden of proof is on the assessee to show that the cash credit is genuine or the investment is not unexplained. The AO should, therefore, always examine as to who has to discharge the burden of proof. It may also be noted that in the course of assessment, the burden of proof may shift from one to the other. For instance, if the assessee discharges his initial burden of proof, the onus shifts to the AO who must bring out facts to refute assessee's version.

14.3 The proceedings under the Income-tax Act are civil proceedings. The degree of proof required in assessment proceedings is the preponderance of probability, unlike in criminal proceedings where proof beyond reasonable doubt is insisted upon. It is open to the AO to show that there is a greater probability of his stand being the correct one as against the stand

of the assessee and show the preponderance of the same, where conclusive proof is not forthcoming.

14.4 The observations of the Supreme Court in *State of West Bengal vs. Mir Mohammad Omar* and Others JT 2000(9) SC 467 made in the context of a criminal case are relevant for our purpose:

> "The pristine rule that the burden of proof in on the prosecution to prove the guilt of the accused should not be taken as a fossilized doctrine as though it admits of no process of intelligent reasoning. The doctrine of presumption is not alien to the above rule, nor would it impair the temper of the rule. On the other hand, if the traditional rule relating to burden of proof of the prosecution is allowed to be wrapped in pedantic coverage, the offenders in serious offences would be the major beneficiaries, and the society would be the casualty.....
>
> .....The function of the criminal courts should not be wasted in picking out the lapses in investigation and by expressing unsavory criticism against the investigating officer. If offenders are acquitted only on account of flaws or defects in investigation, the cause of criminal justice becomes the victim. Efforts should be made by the courts to see that criminal justice is salvaged despite such defects in investigation. Courts should bear in mind the time constraints of the police officers in the present system, the ill-equipped machinery they have to cope with and the traditional apathy of respectable persons to come forward for giving evidence in criminal cases which are realities the police force have to confront with while conducting investigation in almost every case."

The above observations of the Apex Court fit in neatly in our context. They oblige the appellate authorities and the courts to keep the limitations of the AO in mind and see that the revenue is not affected by at times inevitable defects in investigation due to the time and resource constraints under which the investigating authorities operate.

15. INSPECTION OF RECORDS

An assessee has a right to inspect the records and all relevant documents before he is called to deal with the evidence in rebuttal. He also has a right to inspect the statement recorded or order passed by the assessing officer. Under Sec 74 to 77 of the Indian Evidence Act, the assessee has a right to obtain certified copies of any statement, documents or orders forming part of income-tax records if these fall within the meaning of 'public documents'. The following documents forming part of record have been held to be public documents:

1. Statement made on oath before an AO
2. Assessment order
3. Documents filed by the assessee in support of his return of income
4. Income-tax returns
5. Statements recorded and order passed by the AO.
6. Any other material which the AO proposes to rely or has relied on in the assessment order.

16. DRAFTING OF ASSESSMENT ORDER

16.1 Points to Remember

16.1.1 The assessment order should be passed as early as possible after the completion of the hearing. It is the final product that is a culmination of the entire investigation, enquiry

etc. carried out in the course of assessment. It should therefore be a speaking order. As already discussed, a speaking order means that on the face of it the order shows 'due application of mind' by the AO. In a speaking order all explanations and evidence tendered by the assessee and those collected by the AO are duly discussed and cogent reasons are given for every finding. Any finding, conclusion or direction without supporting reasons is likely to be held as arbitrary and struck down.

16.1.2 The order should be brief and to the point. Repetitiveness should be avoided. Issues should be framed point-wise and dealt with accordingly. Merits of each issue should be discussed by first bringing out the undisputed facts, followed by the rival evidence in respect of disputed facts, and the finding of fact in respect of the same. Subsequently the legal principles applicable to the facts should be discussed. Conclusion should be based on clear reasons that have a nexus with the factual position of the case and the law applicable to the facts.

16.1.3 Evidence on disputed facts requires greater discussion. The assessee's version and the evidence furnished by him should be discussed. Evidence collected by the AO should then be highlighted and reasons should be given as to why the factual position given by the assessee is incorrect or false, and how the assessee has failed to counter the evidence collected by the AO when he was duly confronted with it. In other words, in every case where the AO is rejecting the assessee's version, he must give reasons as to why the explanation of the assessee is unsatisfactory or false. He should bring out how the surrounding circumstances and preponderance of probabilities are against the assessee's version. The AO should highlight the points on which the assessee's explanation is inconsistent with the facts on record. Inference should be logically deduced from the established facts. It should be borne in mind that in civil cases, including Income-tax proceeding, the standard of proof is by preponderance of probabilities, and not by proof beyond reasonable doubt as in criminal cases.

16.2 Treatment of Evidence

16.2.1 It should be ensured that all evidence, statements and other documents filed by the assessee are duly signed and authenticated by the assessee or by the holder of his power of attorney. Evidences proposed to be relied on should be marshalled in an orderly manner and then discussed. Language employed in the order should be clear and concise. Flowery language and adjectives should be avoided. The focus must remain on facts and facts alone and not on opinions. Personal comments, derogatory words, or sarcastic remarks should be avoided.

16.2.2 Whenever the assessee fails to give explanation in response to any query or adverse evidences with which he is confronted, this fact should be specifically mentioned. The details of opportunities given to the assessee should be specifically discussed with reference to notings in the order sheet and any other correspondence. No explanation or submissions of the assessee should be ignored. This is a sure way of getting the assessment set aside. Submissions on every issue should be discussed and properly distinguished.

16.2.3 The AO should remember that law follows facts. Therefore, he should apply legal principle and case law only after detailing and establishing the facts. Before applying ratio of any particular decision he should first establish whether the facts of the case are in 'pari materia' with the facts of the case being relied upon. Many a time, reliance is placed on particular entries in books of account or documents seized or impounded from the assessee or third party. Not only should the assessee's explanation in respect of these entries be discussed but also the attested photocopies must be annexed

to the assessment order. Similarly, any other documentary evidence, no matter how bulky, which is material for deciding a particular issue should be annexed. List of annexures must be given in the body of the assessment order. It should be ensured that all the annexures are sent to the assessee along with the order.

16.3 Other key Points in Drafting of Assessment Orders

16.3.1 The first page of assessment order is under a performa ITNS 65. Often the columns of the form are not fully filled in. The AO should ensure that the form is fully filled in.

16.3.2 Sometimes the complete name and designation of the AO is not given at the end of the assessment order. Such details should be typed out and the order must be signed. Every page of the order must be initialed and it should bear the office seal of the office.

16.3.3 It is advisable that for each issue a separate paragraph is used. If the paragraph is likely to be long, it can be divided into sub-paragraphs. It is necessary that the paragraphs and sub-paragraphs be numbered, for easy reference. This facilitates easy reference. The first paragraph should briefly introduce the case and contain such basic particulars as description of the assessee, nature of the business (es) and the returned income. If it is a reassessment or a fresh assessment (consequent on setting aside of the earlier order), a brief history of the assessment should be given in the beginning of the order itself. In the subsequent paragraphs discussions on the contentious issues should follow. The discussion on each issue should first give the facts, then the assessee's version, after those AO's reasons, and finally the conclusion. The conclusion should logically flow from the arguments.

16.4 Simple sentences are more coherent and make for better communication. Therefore in drafting assessment orders compound and complex sentences should be avoided. Ornamentation and embellishments impede the flow of the narrative. However, that is not to say that the order should be dull and prosaic. It can be elegant even when simple, but focus should be on clarity and coherence.

16.5 The tenor of the order should be even and matter of fact. The order should not be partisan. There should not be any irrelevant or tangential discussion. In the order AO should not pay encomiums or give certificates to the assessee. They may prove embarrassing later or impede initiation of subsequent remedial action if required.

16.6 Long tables and long quotations/ reproductions in the body of the order impede its smooth flow. If they should come at all, they should appear as separate annexures.

16.7 Whenever any penalty proceedings are initiated, it should be ensured that the same is also duly noted in the order sheet. The fact of initiation of penalty proceedings should be clearly mentioned in the assessment order.

17. DETERMINATION OF TOTAL INCOME

17.1 The object of making an assessment is to determine total income and the final tax payable by the assessee. Before arriving at total income, what is required to be determined is the 'gross total income'. 'Gross total income' is aggregation of income determined under 'each head of income'. Hence, in respect of each item of income its 'head' should first be determined and then only the income under that head should be computed in accordance with the provisions dealing with that head of income. The AO must also bear in mind the clear distinction between 'source of income' and 'head of income' as there can be a number of sources of income falling under the same head of income.

17.2 It is only after having quantified 'gross total income' the deductions under Chapter

VIA should be allowed. It is possible that where total income is positive, there may still be certain unabsorbed losses. These should be mentioned at the end of the order and it should be specifically stated whether such losses, say, from speculation or the capital gain are allowed to be carried forward. In case the total income is zero or a negative figure all brought forward losses, depreciation etc. should be mentioned year-wise together with current year's loss etc.

17.3 In the assessment order the income should be computed independently of the returned income. Making mere adjustments to the returned income is fraught with danger. In this approach there is a likelihood of the mistakes committed by the assessee in his computation recurring in the AO's computation. After computing the income, the AO should strike a reconciliation of the assessed income with the returned income.

17.4 The AO should be careful while allowing depreciation. The corrections made in the earlier assessments on depreciation should be noted and depreciation should be allowed only on the correct wdv. This fact should be spelt out clearly in the assessment order and the computation with relevant details.

18. DETERMINATION OF TAX

Assessment does not mean determination of income only but also means determination of tax and interest payable by the assessee. A duly signed ITNS 150 form with step-by-step computation clearly given should be served along with the assessment order.

19. EX-PARTE ASSESSMENTS

19.1 Ex-parte assessments *u*/s 144 of the Act can be made where any of the following defaults on the part of the assessee takes place:

a. Failure to make a return *u*/s 139;

b. Failure to comply with all the terms of a notice *u*/s 142(1) calling for production of specific books or documents or for giving specific information or total wealth statement or for furnishing a return of income, etc.

c. Failure to comply with a direction *u*/s 142(2A) to get accounts audited by an auditor nominated by the Chief Commissioner or Commissioner and to furnish the audit report thereof; and

d. Failure to comply with all the terms of a notice *u*/s 143(2) by personally attending the hearing or, as the requirement may be, by production of evidence, in support of the return.

19.2 It may, however, be mentioned that the first proviso to Section144 (1) enjoins upon the AO a strict condition that before passing the order he must serve a notice calling upon the assessee to show cause, on a date and time to be specified in the notice, why the assessment should not be completed to the best of his judgment. This condition is mandatory. However, the second proviso to Section 144(1) dispenses with the requirement of giving such opportunity where a notice *u/s* 142(1) has already been served.

19.3 Even a best judgment issued framed *u/s* 144 has to be based on a fair and reasonable estimate. For this purpose the AO must indicate the consideration that forms the basis for his estimate. Whatever material is available on record and is used for the purpose of making estimate must be highlighted. The observation of the Supreme Court in the case of *State of Orissa vs. Maharaja Shri B.P. Singh Deo* [1970) 76 ITR 690,691] should be kept in mind:

> *"Apart from coming to the conclusion that the material placed before him by the assessee were not reliable, the Assistant Collector has given no reasons for enhancing the assessment. His order does not disclose the basis on which he has enhanced the assessment.*

The mere fact that the material placed by the assessee before the assessing authorities is unreliable does not empower those authorities to make an arbitrary estimate, it is an assessment on the basis of best judgment. In other words, that assessment must be based on some relevant material. It is not a power that can be exercised under the sweet will and pleasure of the concerned authorities."

19.4 The AO must clearly spell out the default committed by the assessee, giving the AO to power to make best judgment assessment.

20. APPEAL EFFECTS

The AO is bound by to give effect to the orders of higher appellate bodies/ courts like the Commissioner (Appeals), ITAT, High Court or Supreme Court. He must give full effect to the order and where certain detailed computation of income or allowance is required to be made on the basis of directions of the appellate authority, he should give due opportunity to the assessee before passing the order. The order giving effect to the appellate order is itself appealable and, therefore, such an order should be a speaking order. Often, for technical reasons, the appellate authority restores an issue with the AO for re-adjudication. In such circumstances the AO is restricted to decide only that particular issue and if any guidelines have been given in the appellate order, to follow those. However, where an assessment is set aside to be made 'de novo', the entire assessment is thrown wide open and the scope of re-assessment is unfettered. Where the matter is remanded to the AO on a particular issue, the AO should carry out the enquiry bearing in mind any other instruction which may be contained in the Remand Order and after giving the assessee due opportunity send the remand report through his supervising officer within the time allowed to him by the appellate authority.

21. MISCELLANEOUS

Though recovery of demand is a separate subject, there is one aspect on which the AO may have to take action in the course of assessment proceedings. Section 281B lays down that where, during the pendency of any proceeding for the assessment of any income, the AO is of the opinion that for the purpose of protecting the interest of the revenue it is necessary to attach provisionally any property belonging to the assessee, he may do so with the previous approval of the Commissioner or Chief Commissioner. Such an order of attachment has to be passed in writing. It may be noted that the action *u/s* 281B can be taken only during the pendency of assessment proceedings (which includes reassessment proceedings).

CHAPTER

22

Evasion of Tax Deduction at Source

1. INTRODUCTION

1.1 The Income-tax Act contains provisions requiring persons responsible for making certain payments, to deduct income-tax before the payment is made to the payee. This mode of collection of income-tax is called tax deducted at source (TDS). Tax is deducted at source from various types of payments like salary, interest, commission, rent, contract payments, winnings from lotteries, winnings from horse races, payment for acquisition of land, payment as fees for technical and professional services, etc. Employers have to deduct tax from salary payments to their employees. Banks, financial institutions and other, while making payment of interest to depositors or crediting interest in their accounts, have to deduct tax at source. The income-tax Act also stipulates the monetary limits and rates at which tax is to be deducted. The persons responsible for deducting tax at source, have to deposit the tax deducted by them in the Government account within the time limits laid down for this purpose. TDS provisions, in brief, have been enumerated in Annexure-1.

1.2 Major types of TDS defaults and TDS frauds:

1. Non-deduction of tax
2. Short deduction of tax
3. Non-remittances of taxes
4. Non-filing of quarterly TDS returns

Beside the above, the Department also comes across various instances of tax frauds indulged in by the unscrupulous tax deductors.

1.3 Sources of Credible information for TDS Investigations:

(I) Major source of information for TDS investigation is available on TRACES portal:

(i) Top defaulters report available in AO report under MIS reports menu

(ii) Data relating to deductors with demand on account of Late Payment Interest (LPI) available in AO Reports under MIS Reports Menu.

(iii) Information of deductors who have not filed Quarterly TDS Returns available as non-filers data in AO Reports under MIS Reports Menu.

(iv) TDS/ TCS Profile Report available in AO Reports under MIS Reports Menu.

(v) Data relating to top deductors of previous year where there is a significant drop in remittances of TDS in the current year.

(vi) Details of prosecution cases selected by TRACES.

(vii) Various other useful reports are made available by CPC (TDS) on the homepage of TRACES from time to time

(viii) Grievance Petitions: Complaints/ grievances filed by the deductees for non-availability of credit of TDS in Form 26AS etc. serve as a good source of information about defaulting tax deductors. Several complaints contain details of non-deduction and non-remittance of TDS.

(ix) Disallowances *u*/s 40(a)(ia) made by the Assessing Officer: During the scrutiny assessments, assessing officers disallow expenses where tax was not deducted or deducted but not remitted.

(x) Form 3CD filed by the assessee: This data may be obtained from CPC (ITR) on specific request.

(xi) Newspaper and other media reports.

(xii) Information shared on the platform of Regional Economic Intelligence Council (REIC) meetings.

(xiii) Searches/ surveys conducted by investigation wing.

(xiv) Information received from I&CI directorate.

(xv) Form 15CA.

(xvi) Form 15G and 15H.

(xvii) Surveys *u*/s 133A(2A).

1.4 Steps in TDS investigation: Investigation in a serious case of TDS evasion may involves following steps:

1	Studying the statutory provisions to establish the jurisdiction and validity of the TDS proceedings.
2	Conducting a survey on-site or on the premises of the assessee to collect primary evidence.
3	Studying and analyzing the data collected in Survey, Post survey, Search, post-search investigations, assessment proceedings and in proceedings *u/s* 201(1), to cull out the relevant evidence.
4	Establishing the factual position based on evidence, and relevant case laws.
5	Determining the nature & quantum of the default. Confronting this to the Deductor and allowing him adequate opportunity.
6	Giving notice under Sec. 2(35) to the Principal Officer of intention to treat him as principal officer in proceedings *u/s* 201 read with relevant Section for non-deduction of TDS. {83 ITR 362, MD cannot be prosecuted *u/s* 276 B unless served with notice *u/s* 2(35)(b)}
7	Drafting an order marshalling all the evidence collected, meeting the arguments and objections raised by the Deductor in its written submission, and giving specific findings, and raising demand of Tax/ interest.
8	Specific direction needs to be given in the order *u/s* 201 for initiation of penalty.
9	Examining the matter for possible prosecution
10	TDS proceedings are independent of assessment proceedings and assessment order need not be relied upon if it is weak. A finding then needs to be given in the order *u/s* 201 that the proceedings have been independently initiated and the facts of the case appraised de novo.

1.5 General Guidelines for TDS Officers: For the AO of TDS charge conducting surveys to detect default in TDS provisions is one of the major tasks. They may take action as per the following norm while conducting such surveys:

a. After identification of a case for survey, necessary information with regard to the premises, directors and sister concerns has to be obtained from the Internet, Income-tax Returns and other available sources.

b. If default in sister concerns or concerns operating from the same premises is noticed prior to survey, permission for conducting of survey in those cases also should be taken.

c. On reaching the premises of the assessee, the business model and modus operandi should be understood by the officer conducting survey.

d. Instead of depending on the assessee's employees for making available various data required from the computer systems, the AO should be able to get access to the system and get all the relevant information including payments and examine the same thoroughly for finding out any non-deduction, deduction at a lower rate or under a different Section, misclassification of expenditure, etc.

e. Details of all sister-concerns, bank accounts, TDS deduction/remittance, directors/partners (name, designation, date of birth, PAN, address, e-mail ID, contact numbers, etc.) along with details of person(s) responsible for complying with TDS provisions and all the information/ statements/ documents required for processing the case for launching of prosecution should be obtained and placed on record.

f. Examine whether TDS is deducted at the proper rate, within time, and deposited within time. Details required for interest *u/s* 201(1A), Penalty *u/s* 271C and DDO/ Principal Officer to be held to be in default *u/s* 201(1) should also be gathered.

g. Audited financial statements and report in Form 3CD of previous five financial years are to be obtained, and if there is any short/ non-deduction, delayed/ non-remittance as per the report in Form 3CD is noticed, the same has to be verified and copies of relevant documents are to be obtained.

h. Unaudited financial statements of current and/ or previous year with details of all the expenses are to be verified with regard to correct deduction/ collection of tax and provisions, if any, made and whether the same have been subjected to TDS. Relevant copies are to be collected in case of any default.

i. Copy of TDS ledger with regard to TDS made, remitted and payable as on the date of the survey has to be obtained and placed on record.

j. Copies of Quarterly TDS Returns filed may be collected.

k. Sworn statement *u/s* 131 has to be recorded from the Director/ Partner/ Principal Officer. The details of default under each Section are to be clearly brought out in the statement. Also, complete details of the person responsible for complying with the provisions relating to TDS are to be incorporated in the statement.

l. A copy of Annual Report, in case of a company, may be obtained.

m. If any requisite information/ document could not be made available during the survey, the same may be called for submission by issuing summons to the Principal Officer/ responsible person of the concern.

2. SECTION 192: TDS ON SALARIES

Any person responsible for paying any income chargeable under the head "salaries" is required

to deduct tax at source on the amount payable at the rates prescribed for the Financial Year in which the payment to employees is made.

2.1 Checklist for Verification of Returns of TDS from Salaries

- Whether tax has been deducted at the average rate of income-tax and deposited within time?
- Whether particulars of gross salary are attached?
- Whether exemption claimed *u*/s 10, if any, is correct? Check the nature of allowances, their extent and the necessary documentary evidence for the same.
- Whether there is any arrangement between employer and employee whereby tax-free income is paid to the employees and the tax payment is borne by the employer? Amount of tax payable has also to be treated as part of salary and TDS to be made out of that [*British Airways vs. CIT (Cal)* 193 ITR 439, *Asian Dev. Service vs. CIT (Ker)* 239 ITR 713].
- Whether perquisites have been correctly valued and offered for taxation? Many employers (especially private companies, multi-nationals and foreign companies) structure salary packages to include various types of payments to their employees which do not figure in the salary certificates given to the Department. These payments are mostly made in cash towards various allowances claimed to be exempt or to defray actual expenses incurred by the employee.
- Whether any perquisites have been paid to the employees in the garb of "reimbursement of expenses"?
- Whether standard deduction is correctly claimed?
- Whether any other income was reported by the employee to the DDO?
- Whether deductions claimed by the employee under Chapter VI-A have been allowed by the DDO after examination of supporting documents for the claim?
- Whether gross tax liability is correctly worked out?
- Details of investment made vis-à-vis the rebate allowed *u*/*s* 88.
- Net tax liability; whether surcharge has been calculated at the stipulated rates?
- Total amount of the TDS made and deposited along with dates.

Reference may be made to CBDT Circular No. 275/ 192/ 2012-IT(B) dated 5th October, 2012 for calculating IT deductions from salaries *u*/s 192.

2.2 TDS from Salary: Some Target Areas for Working Out Perquisites"

- Car(s), conveyance allowance
- Payment of club membership, gym, health club membership
- Credit card membership
- Soft furnishings (curtains, crockery, carpets, lines, cutlery, furniture replacements,
- magazines, other utilities)
- Entertainment allowance
- Servant allowance
- Guest allowance
- House maintenance allowance
- Washing allowance, uniform allowance/ personal attire
- Professional development allowance
- Utility reimbursements
- Assets sold below market price
- Sign-on bonus
- Foreign trips/ holidays
- Relocation allowance

- Stock options (ESOP)
- Guaranteed school admission for children
- Personal computers for home
- Milk allowance
- Responsibility allowance
- Housing loans
- Cruise holidays
- Sweat Equity
- Performance linked payments
- Remuneration paid to doctors by private hospitals
- Genuiness of LTC Claims
- Interest on education loan

2.3 Case Studies

a. The Case of a Large Public Sector Bank: Survey in a nationalised bank revealed that exemption *u*/s 10(5) was being given towards reimbursement of LTC claim of the employees when foreign destination was included in the itinerary of their journey. It was noted that employees used to submit a quotation from a travel agent about the expected expenditure to be incurred towards the travel. This quotation included both the India travel and foreign travel. The employees would travel on flexi/ low-fare tickets but claim of LTC would be significantly higher. Money saved by employees was being used to cover the trip to the foreign destination. The employer would consider and reimburse national carrier prices to the declared destination in India based on the price list given by the travel agent. This was being done despite the bills of actual expenditure incurred for travel within India were available on record. The Department's view that such reimbursement is not eligible for exemption *u*/s 10(5) read with rule 2B, has been upheld by several courts/ tribunals. The assessee's plea of bona fide belief has also been rejected. [67 taxmann.com 81(Kanpur), 80 Taxmannn.com 179 (Bang)]

b. LTC Claim by Shortest Route: Exemption *u*/s 10(5) will also not apply where LTC claim for travel within India is also not by the shortest route. In this connection relevant portion of Circular No. 8/ 2012 [F.NO. 275/ 192/ 2012-IT(B)], dated 5-10-2012 of CBDT which is a Guidance Note for calculating Income-tax Deduction from Salaries Under Section 192is highlighted:

(i) Foreign travel: As per the provision of the rules exemption is not allowed in case of travel abroad.

(ii) The exemption is limited to the actual expenses.

(iii) Where the journey is performed in a circuitous route, the exemption is limited to what is admissible by the shortest route likewise where in the journey is performed in a circular form touching different places, the exemption is limited to what is admissible for the journey from the place of origin to the farthest point reached in India by the shortest route.

(iv) Obligation of the employer: The employer has to satisfy the obligation that LTC/ FTC is not taxable in view of Section 10(5), the employer is not only required to be satisfied about the ingredients of the said Clause but also to keep and preserve evidence in support thereof.

In the case of a large Public-Sector Bank, the AO disallowed the LTC/ LFC where foreign travel component was included. The CIT (A) further made an enhancement by disallowing the claim regarding domestic travel too where a circuitous route was taken.

c. **TDS on Earned Leave Encashement Received by Employees of PSUs/ Statutory Corporation:** Section 10(10AA) specifies the limit of exemption relating to payment received by employees as cash equivalent of Leave Salary at the time of retirement. In case of employees of State/ Central Government "any payment received" is exempt [sec. 10(10AA)(i)], while in case of other employees it is limited to average salary of ten months immediately preceding the retirement/ superannuation, subject to further limit as may be notified [Sec. 10(10AA)(i)]. Under the belief that the organisation surveyed (Bangalore Electricity Supply Company, BESCOM) falls under the classification "State", no tax was being deducted at source on payments pertaining to "Earned Leave Surrender" (ELS) in excess of Rs. 3,00,000/- [in terms of Section 10(10AA)(i) of the Act]. However, such organisations are not state Government, (and accordingly the employees are not State Government employees).The tax treatment of ELS has to be according to the provisions of sec. 10(10AA)(ii). The survey also revealed that there was a BESCOM Circular for internal circulation which admitted that the employees of Bescom are not Government employees and the provisions of Income-tax Act and Rules made thereunder for Non-Government employees are applicable to Bescom employees. The Bangalore Tribunal (KPTCL ITA No. 2223/ Bang/ 2017 order dated 2.5.2018) upheld the position that employees of statutory corporations cannot be regarded as employees of State or Central Government.

d. Rent free Accommodation in the Case of PSUs, Registered Societies, Statutory Corporations: Many times Central and State Corporations and Societies provide accommodation to its employees. Table-1 of Rule-3 of Income-tax Rules 1962 refers to two circumstances for computing the value of perquisite by way of rent free accomodation: Where the accommodation is provided by the Central Government or any State Government to the employees and where it is by "Other employer". According to rates mentioned in the table, value of perquisite and accordingly, deduction at source would be higher in the latter case. But by treating themselves as 'Government", such organisations compute value of the perquisites at a lower level. Various Courts have repeatedly affirmed the position that statutory corporations cannot be regarded as State or Central Government nor can their employees be considered to be holding office or post in connection with the affairs of the Union or State. [Andhra Pradesh State Civil Supplies (148 ITR 497)]. Even if there is control, supervision of the state and audit by a Govt. appointed auditor, it does not become State itself [Gujarat Industrial Development Corporation21 Taxmann 250 (GUJ)] KPTCL (ITA No.2223-2300/ Bang/ 2017, Order dated 02.05.2018), *Central Food Technological Research Institute vs. ITO* in ITA No. 1607 to 1611/ Bang/ 2013, CSIR National Aerospace Laboratories [ITA Nos. 453 to 456 (Bang) 014; order dated 27.8.2014].

e. Payment to Consultant Doctors: Hospitals are found to be deducting tax u/s 194J on the remuneration paid to consultant doctors by treating it as professional income. However, TDS should be made u/s 192 since in most cases there exists an employer-employee relationship. In one case, the survey revealed that besides the on-roll doctors, retainer doctors and consultant doctors were deployed by the hospitals. Huge amounts were paid under the head consultancy fee and retainership fee whereas they were on

similar terms with the company as the on-roll doctors. In cases of consultant doctors, the AO may verify the service rules, working hours, conditions for increment, system of supervision, percentage of fee collected that is retained by the hospitals, contents of the appointment letter, terms of agreement/ appointment etc. It should be verified whether the fee is linked to the number of patients. The objective of such enquiries should be to see whether there is "contract for service" (Sec. 194J) or "contract of service" (Sec. 192). Essence of establishing contract of service lies in evidence of control and supervision by the hospitals over the consultant doctors.

f. Payment to Honorary Part-time Teachers: An Institute proposed to engage honorary part-time teachers on contract basis to take classes in German language. Terms of proposed agreement between Institute and part-time teachers clearly indicated fact of control of teachers by Institute both in regard to work to be done and manner in which it should be done. However, mere fact that agreement gave liberty to teachers to work for any place, institute or company during tenure of agreement and clarified that teacher would have neither the status of employee nor would be entitled to avail benefits of regular employees, would not militate against relationship of master and servant between the Institute and teacher. Therefore, Institute is obliged to deduct tax at source from payment of honorarium to honorary part-time teachers *u*/s 192. [2004] 138 Taxmann 113 (AAR-New Delhi) Max Muller Bhavan.

g. Payment of Retaintership Fee: 'Retainership fees' payment by assessee (a film production company) under the service contract, constitutes 'salary', hence TDS *u*/s 192 is applicable not Sec 194J. The service contract covenants which provide for fixed remuneration, 'termination of employment' Clause, leave Clause, the facts and the evidences established that there existed an employer-employee relationship. Even though no PF, ESI, gratuity, bonus, etc, were paid, payment of these incentives was not conclusive. Red Chillies Entertainment Pvt. Ltd. [TS-86-ITAT-2017(Mum)]

3. SECTION 193: TDS ON INTEREST ON SECURITIES

Section 193 deals with the provisions relating to TDS on interest on securities. Tax is to be deducted under Section 193 if any person pays any income by way of interest on securities to a resident.

3.1 Checklist for Verification

- Whether the assessee has any securities on which any interest is payable?
- Whether amount is exceeding Rs. 5000/- payable to Individual and HUF?
- Total TDS deducted under this Section along with interest debited in financials.
- Whether TDS deducted has been paid within due date and TDS return filed in time?

3.2 Case Studies

Where the assessee made a provision of 'interest accrued but not due' in its books of accounts but the identity of payee could not have been ascertained at the time of making the provision since the bonds were freely transferable, the Tribunal held that no tax was required to be deducted at source. However, the Tribunal also observed that if the assessee knows the identity of lenders, whether the assessee credits the 'interest accrued but not due' in the account of the assessee or in some other suspense account, tax would continue to be deductible *u*/s 193 by the virtue of deeming fiction set out in the

Explanation to Section 193. But the Explanation to Section 193 cannot be invoked in a case where the person who is to receive the interest cannot be identified at the stage at which the provision for interest accrued but not due is made." *IDBI u/s ITO* (2006) 10 SOT 497, 104 TTJ 230 (Mum.)

4. SECTION 194: TDS ON DIVIDEND PAYMENT

Tax is required to be deducted at source by resident companies at the rates in force from dividends before making any payment in cash or before issuing any cheque or warrant or before making any distribution or payment to a share-holder. However, no such deduction is to be made in respect of any dividends referred to in Section 115-O. It must, however, be noted that deemed dividend *u/s* 2(22)(e) still remains subject to TDS *u*/s 194.

5. SECTION 194A: TDS ON INTEREST OTHER THAN "INTEREST ON SECURITIES"

Section 194A deals with provision relating to TDS on interest other than interest on securities like interest on Fixed Deposits, interest on Loans and Advances paid to residents. However, this Section does not apply to interest paid to Banks. [Refer to Section 194A(3)(iii)]

The Payer/ Deductor shall deduct TDS if the amount of such interest paid or credited or is likely to be paid or credited in a financial year, exceeds:

a. 10,000 where the payer is

a. Banking company or any bank or a banking institution

b. Co-operative society engaged in the business of banking

c. Post office (on deposit under scheme framed and notified by Central Government).

b. 5,000 in any other case

5.1 Checklist for Verification

- Whether the deductor has deducted tax on the interest payment exceeding the prescribed limit?
- Whether any interest payment is credited to suspense account or provisions?
- Whether the co-operative society is correctly claiming itself to be a co-operative bank?
- Whether the co-operative society or a co-operative bank is making payment of interest to a non-member which is not exempt from TDS?
- Whether interest is being paid to a director which is not exempt from TDS?
- Whether TDS has not been made for the reasons of the income of resident payee being exempt despite the fact that payee has not obtained nil deduction certificate *u*/s 197 or is not specifically exempt from TDS under the Act?

5.2 Target Areas

a. Companies, firm and LLPs who have made huge borrowings from NBFCs/ private parties, Co-operative societies/ banks

b. Payment of interest in respect of loans and funds taken from sister concerns by companies/ firms/ Individuals and also from Private finance companies as well as from Co-operative credit societies which are not engaged in the business of banking.

c. Payment of interest by builders on advance amount taken from buyers of flat which are subsequently adjusted against sale consideration.

d. Payment of interest by Electricity companies on deposits by its subscribers.

e. Non-deduction of tax on accrued interest on term deposits/ cumulative deposits which are not maturing during the year.

f. Payment of interest by Chit Fund Companies to their members/ Subscribers.

5.3 Case Studies

a. Interest Payment to NBFCs: In many cases, it was observed that there was non-deduction of tax on the interest paid to the NBFCs. The argument of the deductor in such cases is that an escrow account with a bank is opened wherein entire sale proceed is deposited. As per the mandate, the bank where the escrow account is maintained, makes the payment directly to the lending NBFC. Thus, the borrower (deductor) does not have any control over the payment to the NBFC and hence TDS is not made. The argument is not correct. It is the duty of deductor to make payment towards TDS. Subsequently, he may claim reimbursement from the NBFC.

b. Corporation as a Government Body: In the case of a large corporation which had huge fixed deposits in various banks, some of the banks were not deducting TDS on the interest paid to such corporation against these deposits considering the corporation as a Govt body, which was not correct. All these payments attracted TDS 194A. However, before taking any action in this regard it must be ensured that the deductee corporation is not notified by the Central Government for the purposes of Section 194A(3)(iii)(f) [S.O. 3489[No. 17(F. No. 12/ 164/ 68-ITCC/ ITJ)-]

c. Institutions not Exempt *u/s* 194A(3): Many leading star hotels have availed of bridge loans/ terms loans from Tourism Finance Corporation of India (TFCI) and make substantial interest payment. Since interest paid to TFCI is not exempt *u*/s 196 and *u*/s 194A (3), provisions of TDS *u*/s 194A would be attracted.

d. Enhanced Compensation: Under Section 194A, TDS can be deducted from interest realised from enhanced compensation.[2010] 328 ITR 77 (Punjab & Haryana)].

e. Non-availing Compensation: The assessee's primary business involved selling of hotel room nights to its members i.e. the members who subscribed to the membership of the assessee company were entitled to utilize the room nights, as per the terms of entitlement of their respective schemes, at any of the hotels owned by the assessee or its subsidiaries or at other affiliated destinations. The members were also given option to encash their entitlements for non-availing the eligible holidays by way of surrendering their room nights or renting out their holidays to others. In addition to that, the members, at their absolute discretion, could exercise another option to go for premature encashment/ termination of their membership right. (i.e. the non-availing compensation accrued to them). On termination, they were given the deposited amount along with compensation for not availing their rights. If members did not avail entitlements fully or partially during the membership tenure, then they were reimbursed for non-Utilised portion of the entitlements, which was called as NON-AVAILING COMPENSASTION (NAC) and was charged under profit and loss account head. The payment of so called compensation fee (in cases of termination amount over principal amount deposited) for non-availing of the facility by the assessee being a payment made in respect of an obligation incurred in relation to money deposited by the members, was held to be interest, falling within the scope

of Section 2(28A) and the assessee was required to comply with Section 194A.

6. SECTION 194C: TDS ON CONTRACT

TDS is to be deducted on payments for 'work' made to contractors. Where payment is being made to an individual or HUF the rate of deduction is 1% and in other cases it is @2%. The rate of TDS on payments by contractors to sub-contractors is 1%. The term 'Work' has been given wide meaning, and includes advertising, broadcasting, telecasting, transport and catering contract. But, it does not include contracts of mere supply of goods or purchase/ sale of merchandise. Tax is to be deducted on the whole of the invoice value if the value of material is not mentioned separately in the invoice.

6.1 Checklist for Verification

- Whether the contract is a 'contract for work' or a 'contract for sale'?
- Whether the contractual payment is covered *u*/s 194C or 194J. In the case of latter, the rate of deduction is higher.
- Whether the contractual payment has been given the colour of 'sale and purchase' transaction?
- Whether the product is manufactured as per the specifications provided by the client but the material is supplied by another concern. In such a case, the terms of all relevant agreements and relation between client and material supplier must be examined to see if the client can be held to be the real supplier of material?

6.2 Target Areas for TDS *u*/*s* 194C

- Works contracts including fabrication, construction, manufacture
- Extraction, transportation, & supply of stones, sand etc.
- Printing contracts including supply of printed material
- Transport contracts
- Hiring of vehicles
- Courier agencies
- Bus-body building
- Advertising contracts, including hoardings
- Clearing and forwarding agents
- Advertisements in souvenirs
- Contracts for sponsorship of events
- Repairs of vehicles including supply of spares
- Loading & unloading contracts, particularly at ports, & mines etc.
- Contracts for house keeping, plumbing, and electrical work etc.
- Catering contracts
- Security contracts
- Warehousing charges
- Timeshare resorts, holiday homes
- Leasing of hotel-management contract
- Use of airport facilities by airlines
- Rent for hiring of exhibition grounds, exhibition halls
- Payments by airlines for landing, parking, and cargo handling services to Airports Authority of India (AAI)
- Annual Maintenance Charges paid by Govt. Offices/ Government Departments to the service providers for maintenance of computer systems, which include hardware as well as software maintenance, supply of

labour for various works like data entry, housekeeping services etc.

- Job contract given for carrying out works as per specification disguised as purchases.
- Non-deduction of tax on contract payments made to persons for harvesting of sugarcane by companies/ societies disguised as payment made for purchase of sugarcane from farmers.
- Payment made by banks for taking professional services for recovery of bad debts, loan processing, credit verification, etc.
- Payment to transporters.
- Payments made camouflaged as 'reimbursement of expenses'.

6.3 Case Studies

a. **Supply of Material by a Closely Related Party:** Under explanation (iv) to Section 194C of the Act, 'work' includes 'manufacturing or supplying a product according to the requirement or specification of a customer by using material purchased from such customer'. In the case of NNIPL, 3 parties were involved:

   (i) NNIPL the Indian entity that entered into an agreement with TPL for supply of insulin crystals

   (ii) TPL that supplied insulin to NNIPL but purchased material from NNAS, Denmark

   (iii) NNAS Denmark, the parent company of NNIPL

The assessee NNIPL's argument rested on the claim that though insulin was manufactured by TPL as per specification of the customer (NNIPL), but material was not purchased from such customer (NNIPL) but from NNAS, an independent supplier.

This argument was busted by referring to various Clauses of the agreements between these three parties, by bringing on record the ownership structure of the assessee company and its relationship with NNAS. The risk analysis was done. All these documents were discussed threadbare. The sum and substance of the arrangement was that supply of material was by NNIPL only ["such customer"]. The transaction between the assessee and TPL was therefore 'a contract for work', and 'not a contract for sale'.

TDS on Year-end Provisions: In large number of cases, surveys and examination of books have shown that companies make provisions in the books on 31st March but no taxes are deducted at source on such provisions. The assessees contend that the provision is necessitated by accounting principles. Other arguments pertain to the claim that entries have been reversed in the subsequent year, that there is no accrual of income and that suo-moto disallowance u/s 40(a)(ia) has been made. Such an argument that there is no liability to deduct tax at source on the year end provisions is tenuous. Provisions of TDS in the Income-tax Act create a liability to deduct tax at source even when amounts in question are credited to a Suspense Account or any other account by whatever name called, including provision created in books of accounts. This position has been upheld by Courts. (ITAT Bangalore Toyota Kirloskar ITA No.1185/ Bang/ 2014, dt of order 31-10-2017) "It is not possible for the assessee to argue that there was no accrual of expenditure in accordance with the mercantile system of account and therefore the TDS obligations do not get triggered" [ITAT, Bengaluru in the case of IBM India Pvt Ltd [59 Taxmannn.com 107]. The situation may be different if the provisions made at the end of the accounting year are reversed in the beginning of the next year and where no payees are identified or where provision is made in respect of contingent liability for which no deduction was claimed for computation of income [*Karnataka*

Power Transmission Corporation Limited ITA No. 1185/ Bang/ 2014 KHC].

b. Non-deduction of Tax on Payments to Contractors by State Electricity Boards: As per Section 194-C, tax has to be deducted from the gross amount paid or credited to the account of the contractors. In one case, a State Electricity Board had awarded contracts for transportation of coal from the various collieries in Orissa, Bihar, West Bengal etc. to various thermal power stations in the state. These contracts were comprehensive in nature involving loading of coal at the collieries, transportation of the same to the nearest sea ports, unloading it at the sea ports, again loading it into the ships, unloading the coal from the ships at Chennai or Tuticorin ports and again loading and transporting of the same to the thermal power stations. The State Electricity Board, which was supposed to deduct tax on the gross amounts paid to the contractors, was deducting tax only on a portion of the payments made to the contractor. On scrutiny of the agreements between the SEB and the contractors it was found that tax was liable to be deducted on the gross amounts paid. The SEB filed a petition before the CBDT against the orders. The CBDT after calling for reports from the AO etc., held that the orders were legally and factually correct.

c. State Irrigation and PWD Departments and Municipal Corporations: Many Government and semi-government bodies award contracts for construction and other activities. However, because of lack of awareness about TDS provisions, no deduction of TDS is generally taking place. There is, therefore, a necessity for the department to interact actively with these bodies to ensure deduction of tax.

d. Real Estate Sector: It is common knowledge that investments in most of the construction projects are under-stated. During the construction of projects, many expenses are made which are accounted when the construction project is ultimately completed. Therefore, surveys in a on-going construction project, often brings to light several cash transactions as well as contracts and sub-contracts on which taxes are required to be deducted.

e. Transporters are exempted from deduction of tax if PAN of the transporter to whom payment is made, is obtained along with declaration from the transporter that he does not own more than 10 trucks. Often deductions are not made nor PAN and declaration is taken. Apart from this, the transporter is under obligation to mention the detail of payment with PAN in the quarterly returns which is not complied with. In one case, the survey revealed that the company had made payment of Rs. 70 crores approximately to various transporters but TDS was not deducted on the ground of declaration filed by the transporters *u*/s 194C(6). Considering the amount of payment made to each transporters the declaration was found to be wrong. The DDO had failed to deduct taxes on the payments after examining the relevant documents such as invoices raised by the transporters (mentioning the registered numbers of the trucks). The exemption from TDS *u*/s 194C(6) is not available to the payments made in respect of transportation done using hired trucks.

f. Transportation from Farmers' Fields: The assessee, a co-operative sugar factory, entered into agreement with harvester/transporter for harvesting and transportation of sugarcane from farmers' fields with their consent to assessee's factory. Even though farmer was not a

party to the contract, TDS is to be deducted on payment to harvester/ transporter for the said activity [2016] 67 taxmann.com 283 (Karnataka) Ryatar Sahakari Sakkare Karkhane Niyamit.

g. Oral Contracts also Exigible to TDS: Law does not stipulate existence of a written contract as a condition precedent for payment of TDS. Contract may be in writing or it may be oral, but liability to pay tax arises when recipient of said amount receives payment in excess of Rs. 20,000/- [2010] 194 Taxmann 37 (Karnataka)

7. SECTION 194E: TDS FROM PAYMENTS TO NON-RESIDENT SPORTSMEN OR SPORTS ASSOCIATIONS

a. Where any income referred to in Section 115BBA is payable to a non-resident sportsman (including an athlete) [or an entertainer,] who is not a citizen of India or a non-resident sports association or institution, the person responsible for making the payment shall, at the time of credit of such income to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct income-tax thereon at the rate of [twenty] per cent.]

b. Income of a foreign cricket team for participating in a cricket match in India is taxable *u*/s 115BBA and therefore, Section 194E is attracted. The amount paid to the foreign team for participation in the match in India in any form, either as prize money or as the administrative expenses, is the income deemed to have accrued in India and is taxable under Section 115BBA and thus, Section 194E is attracted. With growing popularity of IPL matches in India, TDS on huge payments being made to the non-resident cricketers, coaches *u*/*s* 194E must be examined.

c. However, the payments made to the Umpires or Match Referees do not come within the purview of Section 115BBA because the Umpires and Match Referee are neither sportsmen nor are they non-resident sports association or institution so as to attract the provisions contained in Section 115BBA, although the payments made to them are "income" which have accrued in India, yet, those are not taxable under the aforesaid provision and thus, the liability to deduct tax under Section 194E would never accrue.

8. SECTION 194H: TDS FROM COMMISSION OR BROKERAGE

Every person except Individual/ HUF who is responsible to pay any income by way of commission/ brokerage exceeding Rs. 15,000/- to any resident payee, is required to deduct tax @5%.

8.1 Case Studies

a. Constructive Payment: At times, the two parties involved in the transaction may enter into an agreement whereby charges or the commission are retained by the payee. The assessee' scontention in such cases is that tax can be deducted at source only when the assessee makes a payment of commission, not where the commission is retained. However, the Board's Circular No. 619 dated 04.12.1991 has to be pressed into service in such situations where it is clarified that retention of commission by the consignee/ agent amounts to constructive payment of the same to him by the consigner/ principal.

8.1.1 A TDS survey in the case of travel agencies, who used to do travel bookings either through E-platforms (such as Redbus) and/ or regular bookings revealed that the payments collected by Redbus from the passengers were

being passed on to the bus owners after retaining its commission. This was a case of constructive payment of commission. However, on such commission tax was not being deducted as per provisions of Income-tax Act.

8.1.2 It was found that the Airline operators were collecting charges from passengers and making payment to DIAL after retaining their collection charges. The ITAT Bangalore (ITA No. 581/ Bang/ 2017 order dated 19.4.2018) has confirmed the liability to deduct tax at source in such cases.

8.2 Applicability of Section 194H on Payments in the Nature of Discount: Section 194H defines Commission or Brokerage. This explanation does not include any payment in the nature of discount. A survey actions in pharmaceutical companies revealed that they did not deduct TDS on various discounts offered to their stockists on the ground that discount was in not in the nature of commission or brokerage and that the transaction happened between Principal to Principal (P2P). However, the edifice of arguments of principal to principal transaction got negated when various Clauses of the agreement between the pharma companies and the stockists were examined. The pharma companies were supposed to take back all the expired drugs from the stockist for which it issued credit notes. Some of the Clauses also bound the stockists to take specified quantity of various drugs decided by the pharma companies. Apart from this there were other Clauses also which defied the principle of principal to principal transaction (P2P Transaction). Business entities in order to avoid applicability of Section 194H arrange their affairs in such a way that they give discounts instead of commission. In essence it is commission payment only in the guise of discount.

9. SECTION 194I: TDS FROM RENT

Under this Section, any person not being an individual or HUF (other than those individual/ HUF whose income exceeds the monetary limits specified *u/s* 44AB) who is responsible for paying to a resident any income by way of rent, should at the time of credit of such income to the account of the payee or at the time of payment whichever is earlier, deduct TDS at the rate of 2% for use of any machinery or plant or equipment and at 10% for use of any land or building, if the amount payable/ paid exceeds Rs. 1,80,000/- during the Financial Year.

9.1 Checklist for Verification

- Whether the payments made as rent or any connected activity which is part of rent and also forms part of the rental agreement, is attracting TDS?
- Whether the TDS made on CAM (Common Area Maintenance) charges as part of rent, is being made at the applicable rate of 10%?
- Whether the deductor (Individual/ HUF) is covered by provisions of Section 44AB and is adhering to the provisions of TDS?

9.2 Target Areas for TDS *u/s* 194I

- Deductor companies having multiple show rooms in malls.
- Real Estate Companies.
- Individuals/ HUFs covered *u/s* 44AB.
- All companies paying rent for land, building, plant, machinery and equipment.
- Contractors paying rent for plant, machinery or equipment.
- Renting of space for hoardings.
- Hiring of rooms in hotels.
- Rent for hiring of exhibition grounds, exhibition halls.

- Payment of hire charges for machinery and equipments especially in the construction sector.

9.3 Case Studies

a. Common Area Maintenance Charges: In one case it was found during the survey that the company had made agreement with various mall owners for payment of rent. However, the rental agreements had two Clauses, first being rent for the show-room in the mall and the other being Common Area Maintenance (CAM) charges. On verification of the rental agreement, it is noticed that the deductor compay was paying both rent and CAM charges to the mall owner. While some amount was being shown as rent on which TDS was made at 10%, the balance amount was shown as having paid under CAM charges by making TDS at 2% *u*/s 194C. It was held that CAM charges are also payment for the use of building, hence it also forms part of rent attracting deduction @ 10% *u*/s 194-I.

b. Hiring of Oil Tanks: In the case of an oil company, the assessee had hired oil tanks to store its oil to be distributed later. It deducted tax *u*/s 194C on the ground that this is a contract. It was also argued that the contract was for use of 'Plant', and no TDS has to be deducted. As this was rent towards hiring of storage tanks, the provision of Section 194-I was found to be applicable.

c. Payment Linked to Turnover: In the case of a company engaged in hotel business, an earmarked place was allotted to assessee to carry on a hotel business by an Entertainment Park. The terms of payments were linked to the turnover and not to the period of hire. The reason for this appeared to be to avoid the provisions of Section 194-I. After analysing the contract from various angles, it was found that this payment was covered within the definition of rent *u*/s 194-I.

d. Payment for Use of Lounge at the Airport: Royalty payment made to the Airport Authority of India ('AAI') for use of lounge premises, constitutes 'rent' *u*/s 194-I. The assessee was awarded a contract for running an Executive Lounge at the IGI Airport, New Delhi by AAI pursuant to which assessee was to pay (i) royalty, and (ii) license fee for the space allotted for operating lounge based on the area of lounge premises. The Delhi HC rejected assessee's stand that fees for use of space alone could be categorized as rent *u*/s 194-I, and observed that even though payment was split into two distinct parts, it is in effect payment for use of lounge for the purpose of operating it. The HC held that "The question of being able to operate the lounge without the actual use of the space simply does not arise. The payment for the use of space is inseparable from the payment of royalty for the right to operate the lounge". I.T.C. Limited TS-274-HC-2017(DEL)]

e. Room Charges Paid by Tour Operators to Hotels: Delhi High Court held that the word 'rent' *u*/s 194I has to be interpreted widely and not confined to payments received towards a 'lease, sub-lease or tenancy' or transactions of such like nature. HC remarked that "given the context of the said provision which is intended to cover a wide range of transactions as is evident from the words "any other agreement or arrangement" it is evident that the principles of ejusdem generis or noscitur a sociis cannot be invoked to narrow the scope of those words." It clarified that "Even where the room charges collected by a hotel from its customer is not confined to the use of the space but to a host of facilities

and amenities such payment would still fall within the ambit of 'rent' under Section 194-I". HC also ruled that "Where the payment on behalf of the foreigner is made by a tour operator, such payment would fall within the ambit of Section 194-I and that is a reasonable classification based on an intelligible differentia as to the entity making payment". HC concluded that payment received by hoteliers from persons other than individuals and HUFs constitutes 'rent' [Apeejay Surrendera Park Hotels Ltd. and Federation of Hotel and Restaurant Associations of India 383 ITR 697 (DEL)].

f. **Composite Contract:** TDS *u*/s 194I @ 10% is attracted on composite contract of hiring of vehicles for loading, unloading and transportation of products; TDS *u*/s 194C not applicable as contractee did not carry out any work on behalf of the contractor. [Three Star Granites Pvt. Ltd. [TS-194-ITAT-2012(COCH)].

g. **Parking Charges:** During the course of survey of an airlines, it was found that the company was paying parking charges and deducting taxes @ 2% *u*/s 194C. It was found that the deduction was to be made @ 10% *u*/s 194I of the Income-tax Act, 1961 as the same was in the nature of rent.

10. SECTION 194-IA: TDS FROM SALE OF IMMOVABLE PROPERTY

Under this Section, any person being a transferee responsible for paying to a resident transferor any sum by way of consideration for transfer of any immovable property other than agricultural land, is required to deduct an amount equal to 1% of such sum, if the amount of consideration exceeds Rs. 50 lakhs. The TDS officer may collect information in this regard from the office of I&CI, which regularly collects this type of information.

10.1 Checklist for Verification

- Terms of sale agreement.
- Whether the land in question is agricultural or not?
- Applicability of this provision may be examined incases where the payer buys more than one adjacent property/ flat under separate sale agreements having cumulative consideration of Rs. 50 lakhs or more.

10.2 Target Areas for TDS *u/s* 194-IA

- Builders and Developers of immovable properties.
- Individuals making transactions of immovable properties to be collected from jurisdictional Registrar's office.

11. SECTION 194-IB: TDS FROM RENT PAID BY CERTAIN INDIVIDUALS/ HUF (Applicable W.E.F. 1ST June 2017)

Under this Section, any person being an Individual/ HUF (excluding individual/ HUF whose income exceeds the monetary limits specified *u*/s 44AB) responsible for payment to a resident any income by way of rent* exceeding Rs. 50,000/- for a month/ part of the month shall deduct tax at 5% of such income.

* Rent means any payment by whatever name called under any lease, sub-lease, tenancy or any other agreement for use of any land or building or both.

11.1 Checklist for Verification

- Rental agreement.
- Form 26AS.

11.2 Target Areas for TDS *u/s* 194IB

- Apartments/ villas located in the heart of cities/ towns.

- Residents paying rent to Owners of costly Apartments/ villas.
- Collection of information from CPC (ITR) regarding entities receiving huge rent

12. SECTION 194-IC TDS FROM CONSIDERATION PAID UNDER AGREEMENT *U/S* 45(5A) BY CERTAIN INDIVIDUALS/ HUF (Applicable W.E.F. 1ST June 2017)

Any person responsible for paying to a resident any sum by way of consideration, not being consideration in kind, under the agreement referred to in sub-Section (5A) of Section 45, shall at the time of credit of such sum to the account of the payee or at the time of payment thereof in cash or by issue of a cheque or draft or by any other mode, whichever is earlier, deduct an amount equal to ten per cent of such sum as income-tax.

12.1 Checklist for Verification

- The payments made by the developer to the land owners under Development Agreement may be obtained from the Registrar and examined.

12.2 Target Areas for TDS *u/s* 194IC-

- Builders and Developers.

13. SECTION 194J: TDS FROM FEES FOR PROFESSIONAL SERVICES

Any person not being an individual or a HUF (including individual/ HUF whose income exceeds the monetary limits specified u/s 44AB), who is responsible for paying to a resident any sum by way of fees for professional services/ technical services, remuneration or fees or commission by whatever name called, shall at the time of credit of such sum to the account to the payee or at the time of payment thereof, deduct an amount equal to ten per cent of such sum as TDS, if the amount paid is more than Rs. 30,000/- during the year.

* The amount of TDS will be 2% if the payee is engaged only in the business of operation of call centres. This is applicable w.e.f. 01.06.2017.

13.1 Check List

- Terms of agreement and nature of work being executed.
- Payment of Royalty
- Remuneration to Director other than those covered by Section 192.

13.2 Target Areas for TDS from Fees for Professional and Technical Services

a. Legal, medical, engineering, architectural, accountancy, technical consultancy, interior decoration, advertising, film, I.T.Ps
b. Technical services- rendering any managerial, technical, consultancy services (including supply of services of technical or other personnel)
c. Advocates, lawyers, retainers, legal consultants C.As., ITPs, ICW Asengineers, chartered engineers, architects
d. Surveyors, approved valuers
e. Interior decorators, decoration consultants
f. Film artistes, models, technicians, free lancers
g. Gross payments to hospitals & nursing homes-
h. ESI, defence insurance, GIC
i. Merchant bankers, registrars, credit rating agencies
j. Pagers, internet, database/ data mail services
k. Consultants (tqm, ISO-9002 etc.)

l. Event management, marketing research, celebrity endorsement

m. Landscape consultants

n. Pest control consultation services

o. Payments made by big builders to township planners, land scrapers, architects and technical consultants which fall under the ambit of deduction under various Sections.

13.3 Case Studies

a. During a survey conducted in the case of a Medical College it was found that the trust had not deducted tax on payments made for clinical charges which was technical in nature.

b. TDS *u/s* 194C as Against *u/s* 194J on Payments to Producers of Tele-programmes: Board's Circular No 4/ 2016 clarifies that when a payment for production of content/ program as per the specification of broadcaster/ telecaster is made, TDS on such payment is required to be made *u*/s 194C. However, if in a case, where broadcaster/ telecaster acquires only the telecasting/ broadcasting rights of the content already produced by the production house, TDS *u*/s 194J will apply on payments made by the assessee on account of such contract. In a case of a telecaster/ channel operator, it was found that the assessee had done TDS mostly *u*/s 194C on payments made for various programmes which were stated to have been got produced as per its specifications provided to producers. This was done in view of Circular No. 4/ 2016. The scrutiny of the agreements, however, revealed that there was no programme specific technical specification & all agreements contained similar 4 to 5 general Clauses which mandated the production house to make the programmes in a particular software format or persons working for the programmes were subject to control of the assessee. Thus, there was no programmes specific specifications given by the assessee to the production houses and, therefore, the benefit of Circular No 4/ 2016 was denied.

c. Payments for Maintenance of Operation Theatres: Contract for maintenance of operation theatre and various hospital equipment is not 'routine/ normal' maintenance contract but technical personnel are required for maintenance of such equipment and, therefore, TDS *u*/s 194J and not 194C is applicable on payment under such contracts. Provision of anti-termite treatment for Medical college requires professional skills, TDS is deductible *u*/s 194J. [Govt. Medical College, Jammu [TS-318-ITAT-2012(ASR)].

d. Payments for Customer Support Services etc.: Payment by a telecom company for support services like activations, vendor payment queries, field verification and customer support services such as tele-calling for bill payments, new activations are liable for TDS *u*/s 194J, being in the nature of fees for technical services ('FTS'). It is not possible to provide such support services without technical expertise, skilled manpower and up to date technology of the service provider. The Supreme Court in the case of Bharti Cellular had held that 'technical services' must necessarily involve 'human element'. However, housekeeping services being non-technical in nature will be subject to TDS *u*/s 194C, not TDS *u*/s 194J. [Vodafone Cellular Limited [TS-577-ITAT-2015(CHNY)]

14. SECTION 194LA: TDS FROM PAYMENT OF COMPENSATION ON ACQUISITION OF CERTAIN IMMOVABLE PROPERTY

Any person responsible for paying to a resident any sum, being in nature of compensation, on account of compulsory acquisition, under any law for the time being in force, of any immovable property (other than agricultural land), shall at the time of payment of such sum, deduct an amount equal to ten per cent of such sum as income-tax, if the payment exceeds Rupees two lakhs fifty thousand during the Financial Year.

14.1 Check List

- Details of compensation paid.
- Terms of agreement between purchaser and seller.

14.2 Target Areas for TDS *u*/s 194LA

- Agreements entered into by the office of Special Land Acquisition Officer.
- Government Authorities/ bodies responsible for infrastructure developments, *viz.*, roads, power, rail, economic zones, etc.

14.3 The meaning of "compulsory acquisition" under the land acquisition Act 1894 has been explained by the Hon'ble Supreme Court in the case of *Balakrishnan vs. UOI* [391 ITR 178]. The fact that land owners entered into a settlement with the Collector for the amount of compensation does not mean that the acquisition was not "compulsory".

15. SECTION 195: TDS FROM PAYMENTS TO NON-RESIDENTS

15.1 Section 195 is applicable to all persons who are responsible for paying to a non-resident or a foreign company. It is applicable for any income chargeable under the provisions of the Income-tax Act, except few *(interest referred in Section 194LB/ 194LC, Salary payment and dividend payment u/s 115-O of the Income-tax Act that are covered under the relevant Sections)*. In the regular TDS provisions, TDS is applicable for specific payments whether income is chargeable to tax or not, however, under Section 195 only if income is chargeable under the Income-tax Act, TDS is applicable. Usually in the domestic TDS provisions, there is an upper threshold prescribed, however, in Section 195 it is applicable for any sum. Remittance under Section 195 requires mandatory certification in the nature of 15CA/ 15CB filing which is not required for other TDS provisions. Unlike the regular TDS provisions, there is a interplay of Act and the Double Taxation Avoidance Agreements (DTAA) in interpreting whether any sum is chargeable to tax or not. At a broad level, the Sections applicable under the Act and Treaties for various natures of income are listed below:

Nature of Income	Act	Treaty
Business/ Profession	Section 9(1)(i): Concept of Business Connection	Article 5,7,14: Concept of PE or Fixed Base
Salary	Section 9(1)(ii)	Article 15
Dividend	Section 9(1)(iv) and Section 115A	Article 10
Interest	Section 9(1)(v) and Section 115A	Article 11
Royalties	Section 9(1)(vi) and Section 115A	Article 12
Fee for Technical Services	Section 9(1)(vii) and Section 115A	Article 12
Capital Gains	Section 9(1)(i) and Section 45	Article 13

15.2 Whether any sum is chargeable to tax, requires detailed verification by marshalling of all facts and seeing whether the same is applicable under both - IT Act and the Treaty. As mentioned above, mandatory certification under 15CA/ 15CB is a must for any foreign remittance and 15CA data contains crucial facts like the

nature of remittance such as Management Fees, Royalty, Reimbursement, buyback, long term capital gains, other income, Fee for technical services, amount of remittance, withholding tax deducted, country where amount is remitted etc. The AO should undertake detailed data analytics of the 15CA data and look for probable cases for TDS survey/ inspection. Some of the common scenarios that can be looked into are listed below:

(i) Preliminary Points in Case of TDS Verification: Some of the aspects that the AO may look into are:

a. Income-tax returns, TDS filings, Form 3CEB, Form 3CD for last two years.

b. Estimated TDS payments for the current year in comparison to last two years.

c. Withholding tax remittances (including 15CA/ 15CB) along with the rate applicable at an aggregate level for last year and the current year as on date.

d. Withholding tax deducted but not remitted to the government. TDS ledger in the accounts may be looked into.

e. Lower withholding tax remittances and any lower deduction certificates taken.

f. Remittances to low tax jurisdiction (Singapore, Mauritius, Cayman Island, British Virgin Islands, Ireland) along with the Country by Country Report to understand the functions, assets and risks of the MNE.

g. Earlier assessment proceedings where any disallowances have happened because of non-deduction of TDS and disallowances as per Form 3CD.

15.3 Business Income: The AO may look into whether the remittee has a PE or a business connection within the meaning of Section 9(1)(i) of the Income-tax Act 1961. It is also required to be verified whether India is a place of effective management under the POEM guidelines. It also needs verification whether exemption claimed by the remittee is available under the DTAA. Some of the details that can be looked into are:

(i) Relevant DTAA provisions and analysis of judicial pronouncements, if any, relied upon by the taxpayer

(ii) Country of the Remittee with the Tax Residency Certificate.

(iii) Analysis of relevant Clauses of the Agreement/ MOU, if any, in pursuance to which the transaction took place

(iv) Analysis of functions, assets, risks to check whether the activities are done in India or an arrangement has been carried out just to shift profits out of the country.

15.3.1 Important Case Laws

a. Furnishing of consultancy services by the assessee (a UAE based group company) through its employees would fall within the ambit of service PE under Article 5(2)(i) of India-UAE DTAA. The Tribunal rejected assessee's stand that since the employees remained in India only for 25 days, service PE Clause was not triggered. It held that in the present age of technology, services could be rendered even without the physical presence of employees of the assessee as the services, information, consultancy, etc., could be provided with various virtual modes. It further held that for triggering PE, *services or activities* should have been rendered for more than 9 months; *stay* of the employees was not required for more than 9 months. Assessee's reliance on co-ordinate bench ruling in assessee's own case for AY 2012–13 wherein it was

held that FTS was not taxable in India in absence of assessee's PE in India, was rejected since coordinate bench had not examined with regard to the nature of activities of assessee as to under which Clause of DTAA such activities would fall. [ABB FZ-LLC [83 Taxmannn.com86 (Bang)]].

b. Assessee, a US company and part of GE Group had setup a Liaison Office (LO) in India with permission of RBI for undertaking purely liaison activities. However, survey conducted at LO premises in India revealed that LO premises was permanently used by expats who were working in India for GE overseas entities carrying out sales activites. The activities carried on from fixed place of LO were not confined only to those of a communication channel. The AO treated the LO as a fixed place PE. This was confirmed by the Tribunal. The Tribunal also noted that the GE group entities in India along with expatriates deputed by the assessee were undertaking marketing activities and sales functions of the entire GE group and that GE India along with the deputed employees had the authority to conclude contracts on behalf of the group. Accordingly, the Tribunal also stated that Indian entities of the GE Group as well as the expatriates/ employees of overseas GE entities constituted dependent agency PE. Regarding attribution of income to the PEs, the Tribunal noted that AO carried the exercise of attribution in two parts, *viz.*, calculation of total profit from the sales [worked out at 10% applying Rule 10(iii)] and attribution of such profit to marketing activities [35% of 10% relying on Delhi ITAT ruling in Rolls Royce]. The Tribunal upheld the 10% total profit on sales arrived at by the AO but directed the AO to attribute only 26% towards marketing activities noting that the extent of activities of the overseas entity in making sales in India was roughly 1/ 4th of the total marketing effort. [*GE Energy Parts Inc vs. ADIT* [2017] 78 taxmann.com 2 (Delhi - Trib.)].

c. The assessee Formula One World Championship ('FOWC'), a UK based company, had entered into an agreement with FIA and Formula One Asset Management Ltd ('FOAM') (an associate company of FOWC) by way of which it was licensed all the commercial rights in the Championships for a period of 100 years. For conducting the Formula one Grand Prix in India, FOWC entered into a Race Promotion Contract with Japyee Sports International Ltd ('Jaypee') granting it the right to host, stage and promote the Formula One event in Buddh International Circuit in India for a consideration of USD 40 million for a period of 5 years. The High Court had held that the consideration paid to FOWC was not royalty under Article 13 of the DTAA and that Buddh International Circuit constituted FOWC's fixed place PE India since FOWC and its employees had full access to the Buddh International Circuit and FOWC was granted access for a period of 6 weeks at a time during each season/ each race and that the access was for a period of 5 years i.e. the duration of the Race Promotion Contract and Japyee's capacity to act was extremely limited. Accordingly, it held that FOWC carried on business in India within the meaning of expression under Article 5(1) of the DTAA. The Supreme Court, however, referred to the arrangement between the assessee and its affiliates on one hand and Jaypee Sports on the other hand and observed that the arrangement clearly demonstrated that the entire event was taken over and controlled by FOWC and its affiliates. The Supreme Court rejected the assessee's stand that since the duration of the event was only 3 days, there was limited access granted

which was not sufficient to constitute the degree of permanence necessary to establish a fixed place PE since for the entire period of race, the control was with FOWC. Accordingly, it upheld the findings of the High Court and held that the tests laid down for constitution of a PE *viz.* stability, productivity and dependence were satisfied. It concluded that the Buddh International Circuit was the fixed place of business at the disposal of FOWC, that the taxable event (earnings from the grand prix) took place in India. [Formula One World Championship Ltd. [394 ITR 80 (SC)]].

15.4 Contract Splitting for Avoidance of PE: The most important tax avoidance planning scheme carried out by the MNE's is the avoidance of PE status in India. MNE's have structures/ arrangements which avoid the PE status in India. The most important aggressive tax planning scheme is the contract splitting that is very rampant especially in the EPC (Engineering, Procurement, Construction). Many foreign companies with huge EPC execution capabilities undertake complete turnkey projects providing end to end services. However, for tax purposes, they artificially bifurcate the contracts into offshore component (done outside India) and onshore components (done inside India) to minimize tax payments in India. In many cases of EPC contract, the contractor resorts to a locational spilt, that is offshore and onshore mainly for the purposes of minimizing tax payments in India. The AO should look into the substance on the ground and see whether the same is in consonance with the form as per the contracts. The following issues/ inquiries/ documents may be relevant:

15.4.1 Umbrella Agreement: Usually in all the spilt contracts, there is a wraparound guarantee agreement or the umbrella agreement linking both offshore and onshore components. The agreement links both the offshore and onshore components and ensures that the functions, assets, liabilities, liquidated damages arising out of the total contracts cannot be spilt. When the risks cannot be dissected, it is clear that the offshore-onshore spilt was done only with the instance of minimizing taxes in the countries. AO should collect copy of contract documents in full with all annexures and appendices and obtain a categorical reply that there are no overarching/ umbrella agreements on top of the main contract document defining the risks and rewards.

15.4.2 Tender Documents: The AO should look into the tendering and bid estimation documents. Usually the quotations and the tender intent would be one single contract without any split. All the activities of price estimation for the bids are carried out in India. The initial acceptance is also one single contracts and usually only after this, the contracts are split to minimize the tax liability. AO should look into all communications at the initial tendering stage and see whether the contract was split right from the tendering stage itself.

15.4.3 Project Organisation Chart: AO can look into the substance on the ground. Some of the aspects that can be seen are the project management plan, organisation chart, responsibility matrix. Analysis of project organisation chart could lead to a conclusion that it is one integrated organisation right from tendering stage to commission stage. The day to day functioning of the project managers and profitability reports maintained by the project managers can give insightful evidences on the functioning of the contract.

15.4.4 Contract Man Hours Report: Many a times, man hours are tracked to understand how much work happens in India. This would give a reasonable estimate of how much work actually happens from India. Contract Man Hours Report can be looked into in this case.

It can also be seen, whether the fabrication/ manufacturing setup has been undertaken in India or not. It is noticed that a detailed verification of various stages may clearly indicate

to the AO that the entire contract is one single contract.

The AO can also look into whether the risks passe over for the offshore supply to the party before the consignments lands in India. AO may also do a detailed verification of project management and in deserving cases, examination on oath of the personnel/ executive to scrutinize taxpayer's stand may be undertaken.

15.5 Commissionaire Arrangements for Avoidance of PE: Commissionaire agent represents a principal but concludes contracts in its own name and generally does not legally bind its principal. OECD has explained the commissionaire approach as an arrangement where in a person sells products in a given state in its own name but on behalf of a foreign enterprise which is the owner of these products. Through such an arrangement, a foreign enterprise is able to sell its products in a state without creating a PE. The person selling (the commissionaire) in the state would typically be taxed on the remuneration he receives for his services (often a commission) rather than on the profits derived from such sales. Commissionaire approach shifts high turnover and profits to low tax jurisdiction like Singapore. Usually the principal is likely to be located in a Nil/ lower tax jurisdiction. Principal buys goods from various ground contract manufacturing companies and sells to customers in India using commissionaires. Incomes due to activities of dependent agent are deemed to accrue in India. Income to the extent attributable to operations carried out in India is deemed to accrue in India. In order to align the scope of "business connection" with modified PE Rule as per Multilateral Instrument, explanation 2 of Clause (i) of Section 9(1) has now been amended to provide that "business connection" shall also include any business activities carried through a person who, acting on behalf of the non-resident, habitually concludes contracts or habitually plays the principal role leading to conclusion of contracts by that non-resident and the contracts are in the name of the non-resident or for the transfer of the ownership of, or for the granting of the right to use, property owned by that non-resident or that the non-resident has the right to use or for the provision of services by that non-resident.

15.5.1 In regard to Commissionaire arrangement, the AO may analyse the functions, assets and risks of the foreign entity and see whether it is the principal or the agent who is responsible for most of the activities. AO can resort to Exchange of Information to gather information from the country of Principal and also analyse the various activities carried out by the agent in the country. Organisational structure of the agent and email communications between the principal and agent can be looked into to see whether the arrangement has been carried out with the intention of avoiding taxes in the country. Examination of personnel/ executive to scrutinize the taxpayer's stand may be undertaken.

15.6 Verification of Fee for Technical Services: It is noticed that numerous remittances are made for Technical services without any deduction of withholding tax. As per explanation 2 to Section 9(1)(vii), FTS means any consideration for rendering any managerial, technical and consultancy services. Although the same is taxable under the Act, under some of the DTAAs, the make available Clause needs to be satisfied for the income to be chargeable in India. In this regard, AO should obtain all agreements and other supplementary agreements. If it is a related party transaction, see whether any earlier year transfer pricing audits have been done in regard to the treatment of FTS. AO should seek documentary evidences (emails/ requests for proposal) if any in respect of each service. Details of professionals rendering services *viz.* names of professionals, their qualification, specific dates on which services were rendered etc can be also be looked into. In specific to management fees, details of services rendered along with

board resolutions can be looked into. AO can also see whether there are specific Clauses in the agreement where there are binding Clauses on confidentially and transfer of IPR. It is to be seen whether as part of the management services, there is an access to centralized knowledge repository where key management strategies can be accessed to by the senior management personnel.

15.6.1 Important Case Law

a. The Tribunal held that where the assessee-company made payment to U.K. based company for rendering designing services, the said payment was nothing but FTS as defined in article 13 of DTAA and accordingly upheld the 40(a)(i) disallowance made by the AO. [*DCIT vs. Mira Exim Ltd* [2017] 81 taxmann.com 303 (Delhi - Trib.) - IT APPEAL NO. 125 (DELHI) OF 2014 dated 24.04.2017].

b. The Tribunal held that the payment received by the assessee (Swiss company engaged in providing operations and management services to airports) from Bangalore International Airport Authority Ltd. ('BIAL') for secondment of skilled personnel constituted FTS under the Act as well as under India-Swiss DTAA as all the secondees had expertise in the field of management and were holding very high managerial position. It observed that secondees were under the employment of the assessee and not with BIAL and accordingly, it rejected assessee's contention that payments were salary reimbursements as the seconded personnel worked under the direct control and supervision of BIAL, satisfying the employer-employee test. [Flughafen Zurich AG[79 Taxmannn.com 199 (Bang)]].

c. The Tribunal held that payment made by ONGC (as representative assessee) to a Canadian university ('Non-resident' or 'NR') for collaborative research, participation, training and maintenance services of air injection equipment (used for increasing the recovery of oil) constituted FTS under Article 12 of India-Canada DTAA for AYs 2010–11 and 2011–12. It rejected the NR's stand that know-how/ technology was not made available to ONGC and observed that the service agreement not only contemplated participation but also provided for training and collaborative research between the personnel of NR and ONGC, pursuant to which know-how was shared with ONGC personnel; Further, it rejected NR's alternate stand that even if the receipts were taxable, the same were to be taxed under Section 44BB (special provision for oil exploration companies) since the services were directly associated with extraction and production of mineral oil by holding that Section 44BB was applicable only in cases where consideration was received for services relating to exploration activity which were not in the nature of technical services. Also, it accepted Revenue's plea that since the NR itself was not involved in extraction or production of mineral oil, Section 44BB was not applicable. ONGC as representative assessee for M/s University of Calgary, Alberta, Canada [TS-175ITAT-2017(DEL)] - ITA No.4877/ Del/ 2013 and 1327/ Del/ 2016 dated 28/ 04/ 2017.

d. The Tribunal held that payment received by the assessee (US software company) for rendering implementation, consultancy and maintenance services in connection with 'customized' software licensed to Indian customers, amounted to Fees for Included Services ('FIS') under Article 12(4) (a) of India-US DTAA (which provides that FIS includes payments for the rendering of any technical or consultancy services if such services are ancillary and subsidiary to the application or enjoyment

of the right, property or information for which a payment described in paragraph 3 (i.e. 'royalties') is received). It rejected the assessee's stand that since no knowledge was made available to the Indian customers, the amount could not have been taxed as FIS *u*/s 12(4)(b) and held that for article 12(4) the fee for included services may fall in Clause (a) or Clause (b) and compliance of both Clauses wasn't necessary. Further, relying on the Karnataka High Court ruling in the case of Samsung Electronics Ltd, it held that payment from software supply amounted to royalty. On going through the technical services contract it noted that the services provided by the assessee were for the effective use of the customized software licensed to Indian customers. Accordingly, it held that the contract was for rendering services complimentary and supplementary to the license which would be taxable as per Article 12(4)(a). [i2 Technologies US Inc. [83 Taxmannn.com 143 (Bang)]].

15.7 Verification of Sale of Shares: Long Term Capital Gains or Short Term Capital Gains arises on sale of shares. However, as per DTAAs like with Mauritius, Income from Long Term capital gains is exempt. As a result of this, there is an increasing tendency of MNE's to re-characterise other income received in the regular course as long-term capital gains. AO should examine whether the sale of shares is between associated parties and whether the same is subject to transfer pricing audits. Documentary evidence for full value of consideration, cost of acquisition and any other costs claimed in the computation should be looked into. In case of Discounted Cash Flow (DCF) valuation, the basis for estimation of free cash flows, discount rate, growth rate and valuation of terminal value should be verified. If available, AO should compare the estimated values of free cash flows with the actual free cash flows for examining whether the DCF carried out was genuine or was within the intention of arriving at a pre-meditated valuation. AO can examine on oath the valuer of share and gather more details like whether due diligence and reasonable estimates were undertaken for the purposes of valuations. AO should see reasons for abnormal increase/drop in the free cash flow growth. Usually it is noticed that if the capital gains is not exempt under DTAA, there is usually a substantial under-valuation that is undertaken to minimize taxability.

15.7.1 Important Case Law: Cairn UK Holdings had sold its shareholding in Cairn India Holdings Ltd. (resident of USA) to Cairn India Ltd. The tribunal confirmed capital gain tax holding that shares of Cairn India Holdings Ltd. derived their value solely from the assets located in India as per Section 9(1)(i) of the Act. It observed that the assessee on account of being holding company of Cairn India Holdings Ltd. had held rights in control and management of shares of nine Indian subsidiary companies of Cairn India Holdings Ltd. which controlled Oil & Gas sector in India and accordingly, it categorized these rights as 'property' as defined under Explanation to Section 2(14) of the Act. Accordingly, it rejected assessee's arguments that the transaction was genuine group restructuring as a result of which management and control remained in the same hands and accordingly, conditions stipulated in the definition of the term 'property' were not satisfied. It further rejected assessee's contention that no real income had accrued to the assessee on the ground that the financial statements of the assessee reflected that the assessee had earned substantial gain on sale of shares and on account of taxes not paid by it due to exemption claimed on capital gains. It also rejected assessee's contention that this was transfer by way of exchange and not sale and accordingly, FMV of the asset received in consideration for the assets transferred should be taken as full value of consideration and cost of acquisition should be stepped up to the fair value of the shares of Cairn India Holding Ltd. on the date of acquisition and upheld AO's computation

of capital gain by deducting from full value of consideration, the actual cost of acquisition incurred by the assessee for acquisition of the property i.e. original cost of shares. The Tribunal rejected the assessee's contention that since Indo-UK DTAA notified in the year 1994 provided for taxation of capital gains tax as per domestic tax laws of the contracting state, the domestic law prevailing in 1994 should be applied and held that provision in the DTAA cannot make the domestic law static and such article in DTAA also cannot limit the boundaries of domestic tax laws. [Cairn UK Holdings Limited [79 Taxmannn.com 128 (Del)]].

15.8 Re-characterization of Dividend as Long-term Capital Gains: Many MNE's have tax benefits and have huge accumulated reserves in India. Distribution of any accumulated profits in any form is taxable under Section 115-O or Section 115A. However, these transactions are re-characterised as buyback of shares under Section 77A of the Companies Act or through scheme of arrangements under Section 391 to 394 of the Companies Act, where the dividend payments are re-characterised as capital gains. In case the shareholder is in Mauritius or other low tax jurisdiction countries, the payments of the capital gains taxes are exempt. In this case AO should see whether Section 115QA is applicable or not on the buyback of shares. Copy of valuation report (along with annexures) may be looked into to see how value of shares was arrived at. Copy of resolution of the board approving the buyback scheme, High Court order, if any, may be looked into. Comparison of the current valuation with the prior year valuation and comparison of projected free cash flows may be looked into. AO should look into the genuineness of the assumptions behind the estimation of free cash flows, discount rate, growth rate and valuation of terminal value. In Pre June 2016-cases, it should be seen whether the same is chargeable to tax under Section 2(22)(d) or 2(22)(a) of the Income-tax. In all these cases since dividend has not been remitted as per Section 115-O of the Income-tax Act, dividend needs to be taxed in the hands of the nonresident as per Section 115A of the Income-tax Act. AO should see whether the recharacterization is a colorable device and bring in more factual evidences to prove the recharacterization.

15.9 Verification of Place of Effective Management: In many cases it is noticed that dual residency is used for shifting the place of effective management to a place where there is low tax incidence. In this scenario, many DTAAs have prescribed tie breaker rules and also brought in suitable amendments in the Act. AO should look into whether puppet/ shell companies are used to shift the taxes to low tax countries where the capital gain is exempt. The following points may be looked into by the AO while verifying the Place of Effective Management:

a. Place where majority of the Board of Directors or equivalent body usually meets. The place of implementation of the entity's overall group vision and objectives.

b. The place where company's financial decisions (e.g. borrowing, lending, raising capital and financial risk control, etc.) are made

c. Location of and functions performed at headquarters of the company.

d. Where controlling shareholders/ parties other than Board of Directors make key management decisions.

e. The place where the chief executive officer and other senior executives usually carry on their activities

f. Location of senior managers residence

g. Place where the members of the managing bodies are residents

h. Place where minutes of board meetings and shareholders meetings are located

i. Place where Company's Books are Located

j. Place where company's records and other administrative documents are managed

k. The place where Balance Sheet, P/L and Annual accounts are drawn

l. Location where the official seals of the company are located

m. Place where Company's major properties/ assets are located

The AO may also look into the POEM guidelines of the CBDT along with the above crucial points.

15.10 Equipment Hire: AO can see whether there is a hire of equipment since the same would be taxable as royalty under the provisions of various DTAAs. In this regard AO can look into the details of nature of equipment, technical specification, nature of usage and situs of the equipment. The details of extent of control over the equipment vested with the assessee along with proof can be looked into. Details of the risks involved in the usage of the equipment and terms for bearing of such risk may be verified. AO may also examine Clauses of agreement for provision of equipment which contains the duration and the terms of usage along with all annexures and further supplementary agreements or any other amendments. AO can also see whether the equipment is manually operated or automatic and the extent of human intervention involved. If automatic, the address of the location of the equipment, number of employees located at that location, their designation, qualification, work profile may be looked into. If the equipment is a ship or container, verify the detailed day to day movement chart of the container/ ship for the last 3 years.

15.11 Purchase of Software License: AO can look into whether the software is off the shelf or customized. In most of the cases the provisions of royalty would be applicable. AO can verify whether the software is customized by looking into the details of third party vendors and the contracts signed with them. Nature of usage of software, proof for all details of communication with software vendor, details of visit of the software vendor to the assessee site may be looked into. AO can verified whether the assessee would be liable to be sued for exploiting the software without permission, nature of rights transferred and whether assessee has right to make copies of the copyright protected software. In case of a hardware is bundled with software, details of value of the software *vis-á-vis* the value of the equipment as a whole and the detail of extent of right to reproduce, modify and commercially distribute the software embedded in the equipment for operating the equipment may be looked into. In the Indian context, the High Courts have had divergent views, drawing a distinction between payment for the use of a copyright and that for a copyrighted article. On the one hand, it has been held that "license is granted to make copy of the software (contained in shrink-wrapped/ off-the-shelf software) and to store it in the hard disk and to take a copy and right to make a copy itself is a part of copyright." Accordingly, what is transferred is right to use the software (Karnataka HC in Samsung Electronics Company Ltd.) On the other hand, several Courts have held that no right is transferred in the case of sale of software [Delhi High Court in Ericsson]. As on date, the matter is pending before Hon'ble Supreme Court.

15.12 Verification of Cost Allocation Agreements: Usually these payments are made as reimbursements stating that there is no income element in this. However, the AO has to verify the nature of services provided and see whether the same can be brought under Fee for technical services or provisions of royalty are applicable. In this regard, Copies of agreements, documents, licenses etc entered into with thirdparty suppliers/ licensors/ developers by the AE, reflecting the cost to the AE under such agreements may be verified. Detailed documentation for costing of any software and third-party confirmations may be looked into. Rights in respect of such software retained by the AEs and not shared with the assessee and the cost in respect of the same may

be verified. In case of software applications, global users and head counts may be verified. In cases of support services, total number of instances of such support may be looked into. All the email correspondences relating to the technical support may be looked into. The basis of charging of the support services may also be looked into.

15.13 Verification of Secondment of Employees: In case of secondment of employees to Indian subsidiaries by the parent company, list of employees, designation, role played, period of stay in India may be called. The basic need for the secondment of such employees may be looked into. Copy of employment agreements of the seconded employees may be verified in detail. Sometimes it is also better to look at termination agreement which gives valuable insights. Details of reporting structure of such seconded employees and copy of appraisal reports of such employees may be looked into. Based on this, AO may treat this as Fee for Technical Services. Further information about the seconded employees may also be gathered from their LinkedIn profiles.

15.14 Verification of House Property Income: In this case proof of ownership/ title of the immovable property let out may be looked into. Rental agreement between the remitter and the remittee may be verified. In case of sale of immovable property where capital gains is arising, genuineness of the deduction may be looked into by looking into various documentary evidences for full value of consideration, cost of acquisition etc.

15.14.1 Important Case Laws

a. The Tribunal held that consideration received by the assessee (a UAE based group company) from ABB Ltd. (assessee's Indian counterpart) pursuant to rendering technical services, constituted 'royalty' under Article 12 of India-UAE DTAA. It rejected assessee' sargument that the amount was not taxable in India as neither did the DTAA have a specific FTS article nor was Article 22 ('other income') applicable as assessee did not have a PE in India. It observed that the service agreement gave opportunity to ABB Ltd of using the information pertaining to industrial/ commercial/ scientific experience belonging to the assessee which would fall within the ambit of 'royalty' definition underArticle 12(3) of India-UAE DTAA. [ABB FZ-LLC [83 taxmann.com 86(Bang)]].

b. Where the assessee made payments to a German based company for sharing its standard operating procedures (SOPs) access to database, email server, hardware and software etc, the Tribunal held that since it was consideration for sharing of scientific, or for that purpose industrial and commercial experiences, same was taxable in India as royalty under article 13(3) of India-Germany DTAA. Accordingly, it upheld the AO's order issued under Section 201 of the Act. [Oncology Services India (P.) Ltd [82 Taxmannn.com 42 (Ahmedabad)]].

c. The assessee, a Singapore based ship company engaged in the business of operation of ships in the international traffic claimed exemption under Article 8 of the India-Singapore DTAA but the AO denied the deduction on the ground that there was no evidence that the money had been actually remitted to Singapore and had suffered tax in Singapore. Accordingly, the AO denied treaty benefits under Article 24. The assessee during the Tribunal hearing filed a certification from the Singapore Authorities stating that the income had been brought to tax in Singapore. However, during the hearing, the Tribunal observed that as per the Singapore tax laws, the income of the assessee did not seem to be taxable in Singapore itself and therefore as per Article 24 if income has

not suffered tax in Singapore, no benefit under the DTAA could be granted. It held that there was a difference between 'subject to tax' and 'liable to tax'. In light of the new developments in the case, the Tribunal remitted the matter to the file of the CIT(A) for fresh adjudication. [*BP Singapore Pte Ltd vs. ITO* [88 Taxmannn.com 226(Rajkot)]].

d. The reimbursement of expenses for intranet and SAP charges made by the assessee to its German holding company were held to constitute royalty under the Act as well as DTAA. The Tribunal held that the SAP software was customized and the payment was made for the use of licensed software and therefore the payment made by the assessee constituted payment for use of scientific equipment under the Act as well as DTAA. It rejected the contention of the assessee that since the payment was only a reimbursement of expenses, no tax was to be deducted, noting that the assessee failed to produce any agreements, contracts or working to substantiate its claim. It held that if the contention of the assessee was to be accepted then all payments to a third party routed through a holding company would be considered as reimbursement of expenses, rendering the provisions of the Act and DTAA redundant.[SMS Iron Technology Pvt Ltd [88 Taxmannn.com 277(Del)].

16. TDS FRAUDS

Earlier TDS functions were handled manually and the AOs used to get these TDS certificates verified from the respective deductors and the process used to take a lot of time resulting into delay in issue of refunds. There also used to be a lot many cases of TDS fraud as people could get such TDS certificates printed and issued and could skip the verification process. To overcome this, computerization of TDS functions happened a few years back and CPC-TDS came into existence with TRACES system. CPC-TDS was thus conceived with the purpose of eliminating attempted frauds by unscrupulous elements, who during the earlier 'paper TDS Certificate' regime, used to forge fictitious TDS Certificate and file bogus or false Income-tax Returns to claim Refunds that were not legally due to them. However, unscrupulous elements have still found innovative ways of making fraudulent refund claims

- by stealing identities and access codes;
- by using historical data and flexibility to modify claims of the past to claim refunds fraudulently.

Some of the typical modus operandi adopted by them are summarized below for reference:

16.1 TDS Fraud by Revising TDS Statements: Quarterly statements u/s 206 are filed for tax deducted at source by the respective deductors. Deductor files quarterly TDS statements for all quarters with correct details of deductees. Thereafter, the deductor files revised TDS statements by replacing original deductee details with PANs of other deductees who are not connected with the deductor. The bogus deductees so introduced in the revised quarterly statements get credit in their form 26AS and become eligible for refund. The bank accounts of these new/ bogus deductees are managed by scamsters who are generally chartered accountants/ representatives of the deductors. Therefore, the refund amount is credited to the account of the bogus deductees mentioned in the revised statements filed by the chartered accountants/ representatives of the deductor. The genuine deductees do not have any information about all this happening behind their back and thus become future complainants with regard to non-grant of Tax credit by the deductor.

16.2 Non-deposit/ short Deposit of TDS by Deductor while Assigning much Higher TDS Credits to its Deductees: Deductor first reports tax deductions in the TDS statements after depositing only a marginal TDS amount.

Deductor deposits a part of TDS and he may have claimed the same challan in different quarters and the claimed amount in TDS statement against the underlying deductees is more than the total amount deposited. This results in overbooking. Deductor does not deposit any TDS and he enters bogus challan particulars in TDS statements with the intent of fraud. The defrauding entity then makes the underlying deductees (taxpayer) claim the above TDS credit in their Income-tax Returns. On receipt of refund by taxpayer, deductor updates TDS statements for some of such taxpayers by reducing the transaction and TDS amount to zero or some other reduced value. This correction/ update of TDS statements may have been made with the intent to reduce/ clean up short payment TDS default without paying any tax. This cleans up deductor's record, while the corresponding demand created against the deductee remains unpaid because the deductee is either fictitious or non-traceable.

16.3 Substitution of Unrelated Person's PAN with the NON-PAN Entries: Banks and other Financial Institutions, in the cases of persons who do not supply their PANs, deduct TDS at the higher rate of 20%. The deductors other than financial institutions also, if duductees do not provide their PAN deduct the TDS at 20% and report the same in the TDS statement. Consequent to processing of such TDS statements, all such TDS credits (at a very high rate of 20%) remain unclaimed as there is no PAN against these deductors. Such TDS credits are very lucrative targets for fraudsters, as by simply gaining access to such TDS statements, they can enter any PAN details and get a Tax Refund in the ITR of such PAN. The fraudsters maintain a set of such PANs, which they keep using for claiming fraudulent Refunds. Fraudsters target hapless and innocent Banks & Financial Institutions and corporates and steal their access codes to manipulate their TDS Statements. Sometimes the intermediaries and accountants working for such deductors also indulge in such fraudulent activities, as they have access to such deductors' User-Ids and passwords.

16.4 Incorporation of Unrelated PAN in Genuine TDS Statement that too with No Tax Deposit: Some firms/ Govt. organisation/ Financial institutions hire CAs or Accountant for filing their TDS Statement. If such a CA is a fraudster, he would file the transactions and TDS details of TDS statements of the organisation containing all such transactions but add some fictitious deductee rows showing false TDS deductees without making any TDS payment. The same CA or Accountant would then claim fraudulent refund in the ITR of the fictitious person whose details he enters in the TDS statement of the organisation. On receipts of the refund by the taxpayer, the CA updates TDS statements of the organisation by reducing the TDS deductions of fictious persons to zero. This way, the deductor would never notice the fraud committed by its CA.

16.5 Filing of Regular TDS Statement of an Organisation Knowingly Followed by Adding Unrelated Deductees in Correction of the Previous Statements: In some cases, some person gets the user ID and password of the firms/ organisation. So for making correction in the previous statements, they file the regular return of the firm/ organisation for getting the latest KYC details. Then they make correction in previous statements by adding some unrelated deductee by mentioning bogus challan or adding deductee against 'PAN not available' entries to get the refund. Underlying deductee claim the above TDS credit in their Income-tax Return-V. This causes Short payment to the genuine deductor and then the deductor comes to know about default through the intimation. Now the deductor is not able to file the regular statement and will not even be able to file the correction as well. Then they need to cancel the statement through CPC TDS.

16.6 Fraud by Changing the Date of Deduction/ Quarter of Deduction

16.7 Manipulation of 15G and 15H Forms

16.8 Case Study 1: In the case of X X Fashion Processors Ltd., the CPC-TDS noticed frequent revision of quarterly TDS returns, as many as 19 times and 13 times in A.Y. 2015–16 & 2016–17 and therefore asked the field TDS to cause enquiries. On verification it was noticed that there were manipulations in quarterly TDS returns in cases of as many as nine companies by a single intermediary, and huge refunds were claimed out of which seven companies related to Mumbai charge. Thereafter, further investigations were done by Mumbai and Thane TDS. It was noticed that this TDS fraud was being done by one M/s ABC and associates, a Mumbai based intermediary firm engaged in filing TDS and tax returns and main culprit was one X, Sr. Accountant working with M/s ABC and Associates. During the investigation, M/s ABC Associates filed a letter dated 21/ 08/ 17 along-with an affidavit alleging that this entire TDS fraud and refund scam has been done by X, his employee who was entrusted with the work of TDS filing, without his knowledge. Thereafter the main culprit X was summoned and interrogated wherein he confessed in a statement on oath *u*/s 131 that he has done this TDS fraud in respect of nine companies and obtained refunds of Rs. 57.10 lacs fraudulently by filing revised TDS statements and manipulating deductee details. During investigation carried out by Thane Charge & later on by Mumbai TDS charge, it was found that X had revised TDS statements in respect to 9 deductor companies by revising quarterly statements and introducing bogus deductees, thus getting TDS credits in their AS-26 and claiming refunds. The login ID & passwords of all these 9 deductors were with X who used to file TDS statements and correction statements on behalf of these entities. He had confessed in a statement given under Oath that TDS statements were first filed on behalf of all the deductors by mentioning correct PANs of the deductees. Thereafter, he used to revise the TDS statements by replacing original deductees with bogus deductees, whose PANs were obtained by X fraudulently. In case of one Deductor Company, X had replaced original PANs by as many as 15 bogus PANs. These bogus PANs were obtained by him from a person doing the work of obtaining PAN cards. All such bogus PAN cards were obtained by X without giving any proof or KYC. The 15 bogus deductees get credit for TDS payments by deductor in place of original deductees and got refunds in their respective returns processed by CPC Bangalore. Later he again filed correction statements replacing bogus deductees with the original deductees and thus cleaning the manipulation. The irony is that these deductors do not have any knowledge about the manipulation of deductee details in their TDS statements.

16.9 Case Study 2: In case of a well-known telecom company, an expenditure of Rs. 4.6 Cr was debited in the P&L account, but tax was not deducted on the above sum in quarter ending March 2013. This was reflected as such in the Q4 TDS statement of 2013 also. The deductor later revised its Q4 return deleting the above expense and hence TDS liability also extinguished. The assessee later filed Q4 return of 2014 showing above expense payment and TDS payment as well over it. However, assessee had not revised ITR return and 3CD audit report for FY 2012–13 reducing above claim of expense from P&L account and 3CD report still read as 'Tax paid on above amount before due date of filing return i.e. on 31/ 10/ 2013. Thus, assessee made double claim for same expense in two years and also tried to avoid interest liability *u*/s 201(1A) for one year on delayed payments. In prosecution proceeding before the CIT-TDS, Delhi, the assessee claimed that he never incurred the expenditure during the FY 2012–13 and therefore no TDS was done in that year and that the expenditure was actually incurred in FY 2013–14 in Q4, wherein TDS was deducted and paid. However, the fact remains that in audit

report for FY12–13 they showed as TDS amount outstanding as paid at the time of filing of return, with a view to avoid addition *u*/s 40a (ia). By doing this the assessee tried to reduce the liability of interest u/a 201(1A) by 12 months and also tried to escape from prosecution. However, the vigilant CIT caught the assessee and not only Sectioned the prosecutions but also inform the jurisdiction PCIT to initiate proceedings *u*/s 263/ 148 for disallowance *u*/s 40 (a)(ia).

16.10 Case Study 3: In CCIT (TDS), Delhi charge an attempt was made to claim refund fraudulently of TDS amounting to Rs. 2 crores pertaining to Hon'ble Supreme Court of India, under 'no PAN available' category. It was noticed that TDS credit in name of Supreme Court of India was claimed fraudulently in name of a PAN ABAPE2520L (in name of xx) and in this regard TDS statement of Union Bank of India, Daryaganj, New Delhi was revised, with a view to claim refund of above Rs. 2 crores. The matter was accordingly handed over to CBI.

16.11 Case Study 4: ITO TDS Madanapalle, Andhra region, received certain complaints of malpractices against TIN facilitation centre there. He carried out a survey on one Shri Srinath running a TIN Facilitation Centre. The outcome of survey operations shows a peculiar modus operandi adopted by TIN Facilitation Centre of manipulating the tax deduction particulars furnished by several government tax deductors and thereby making bogus claim of refunds. One particular PAN was being used by three different TANs statement data was analyzed by the CPC-TDS. It was observed that the fraudulent PANs were used where no PAN available data was filed by the deductors. The above Centre introduced PAN of their relatives against those data and claim refund. It was also noticed that these PANs were getting credit from 8 different TANs. It was also noticed that all these TANs were quoting same unmatched challan of Rs. 100,000/- in name of Satguru Export and Import. It was further found that same fraudulent PANs were used in the case of different deductor whose return was filed from same Centre.

16.12 Case Study 5: In a TDS survey in case of a well-known Builder in Mumbai, it was noticed that it devised a very innovative strategy to dupe the Department. Though it had significant interest expenditure of about Rs. 734 cr, majority of expenditure to its sister concerns, but it was not making any TDS on the interest payment to sister concerns, even though the expenditure was covered by TDS provisions. In fact in F.Y. 2016–17 it did not make any TDS on interest of Rs. 554.40 cr and in F.Y. 2017–18, on payment of Rs. 345.82 crores; the total of which works out to 900 cr and non-deduction of TDS at the rate of 10% works out to Rs. 90 crores. When it was confronted about non-deduction it gave a very evasive reply that in view of amended provisions and addition of proviso to Section 201, he may not be treated as an assesse/ deductor in default, as the deductees have already filed their tax returns and have cleared their tax liabilities. As the interest was being paid to the group companies it could manipulate the date of credit of interest easily at its will and avoiding payment of due TDS. Nonetheless there has to be interest liability of about 3.5 crores *u*/s 201(1A), which it had to pay. Further, in F.Y. 2017–18 there was interest payment/ credit of 410 crores, out of which on 345.82 crores TDS was not made, so it was asked as to why no TDS was made on the current year's interest expenditure, selectively. The assesse responded that it has actually not credited this interest and the accounts referred to were tentative accounts, even though the same were produced by the assesse itself. However, this explanation of the assessee was rejected.

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